F. A. Hayek

Critical Review

An Interdisciplinary Journal *of* Politics *and* Society

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Jeffrey Friedman

HAYEK'S POLITICAL PHILOSOPHY AND HIS ECONOMICS

This is the second issue of *Critical Review* devoted to the work of F. A. Hayek. The first was published in 1989, at the apogee of Hayek's political influence. In that miraculous year, Hayek's ideas were paid attention not only in some quarters of the U.S. and British governments, but even more so among the Eastern European liberals who suddenly found themselves in power.

Nearly a decade later, however, Hayek's political influence has been exposed as ephemeral. Nor should it have taken the election and re-election of Democrats, Labourites, Socialists, and Eastern European nationalists to drive home the unpopularity of Hayek's free-market liberalism. As Hayek himself emphasized, the alleged benefits of capitalism are counterintuitive, and there is never a shortage of politicians and publicists ready to blame it for every ill.

Even in the United States—where, in theory, big government has never been popular—the manifold opportunities government offers for redressing perceived injustices and inefficiencies has been well accepted from the very beginning. Abstract opposition to big government should not be confused with concrete opposition to its many works. Entitlements and regulations that are seen as serving a good cause with a modicum of efficiency have always been accepted; a pragmatic people has always considered laissez faire "extreme" and ideological. The paralysis that has gripped Republicans since the 1996 campaign stems from a simple truth: the public does

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not support real action to reduce either the size or the power of the state. (See Page and Shapiro 1992, ch. 4; Wessel and Wartzman 1995).

Abroad, where there is not even a tradition of abstract opposition to statism, the notion that Hayek is influential in contemporary politics is still harder to credit. Indeed, as Andrew Gamble suggests in his penetrating new study of Hayek (Gamble 1996, 79), Hayek's thought revolves, in large part, around the tension between, on the one hand, what he believed economics teaches us about the benefits of capitalism; and, on the other, the public's unreadiness to understand, let alone endorse, these teachings. If Hayek's argument is sound, then it would be almost impossible, according to that very argument, for the public to accept it.

It is fitting, then, that our special issue opens with Peter J. Boettke's magisterial discussion of Hayek's economics. As Boettke indicates, Hayek's economic thought is now almost completely forgotten—except, in the work of the new "information economists," as a source of seminal but superseded insights into the epistemological function of prices. Even among "Hayekians," Hayek's arguments against "constructivist rationalism" and the "mirage" of social justice, and his version of the "constitution of liberty," are cherished far more than his economic ideas. Boettke manages to resurrect Hayek the economist by showing that he was not so much defeated as misunderstood, and that this misunderstanding illustrated the severe limitations of the type of economic theory that is now hegemonic: mathematical formalism.

Formalism, Boettke argues, cannot deal with the economic realities that were central to Hayek—temporal change, uncertainty, and ignorance. Mathematical economists must omit these factors from their models, leading them either to view reality as if it were the algebraic utopia their models do capture, or to imagine that such a utopia could exist if reality could be properly regulated. In the form of the battle between Chicago-school laissez faire and Keynesian interventionism, this choice between utopias has almost completely dominated the economic theory of the last six decades. Hayek's attempt to theorize about the actual, unformalizable conditions of economic life under capitalism has been forgotten.

Boettke succeeds in making interesting what, in the hands of other economists of Hayek's long-marginalized Austrian school, has often seemed a doctrinaire, unrealistic assertion of the superiority of laissez faire. By comparing the Austrian school to its formalist

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successors, Boettke shows that it is actually the latter who have left reality behind, affirming their preconceptions about the superiority of either markets or states by dogmatically inserting the necessary assumptions into their models of equilibrium. According to Boettke, then, any remedy for the fantastical qualities of modern economics will have to begin by returning to Hayek: that is, by abandoning the present-day preoccupation with technical wizardry. Instead, economists—or, more realistically, political economists in other disciplines—will need to treat all models as ideal types that may or may not apply to the real world. In practice, this means accepting the irrelevance of equilibrium models, except as counterfactual heuristics—despite the marvelous possibilities those models open for mathematical reasoning.

Boettke's Hayek is such an effective antidote to mainstream economics that it makes one wonder why Hayek turned to political philosophy. Gamble (1996, 18–19) offers a persuasive answer, suggesting that since Hayek blamed the misunderstanding of his economics on "rationalism," he felt obliged to turn his fire in that direction. This first led Hayek to make implausible forays into intellectual history, tracing fascist ideas to socialist ones (*The Road to Serfdom*, 1944)[1] and, in turn, tying socialism to an "engineering mentality" that originated in Napoleonic Paris (*The Counter-Revolution of Science*, 1952).[2] Only then did Hayek begin publishing increasingly antirationalist formulations of classical liberal philosophy (*The Constitution of Liberty*, 1960; *Law, Legislation, and Liberty*, 1973–1979; *The Fatal Conceit*, 1988)—verging on irrationalist traditionalism by the end of his career. In the philosophical works—the subject of essays in this issue by David Johnston, Ryszard Legutko, Steven Lukes, and Juliet Williams—Hayek spells out his opposition to what he thought of as the constructivist hubris in politics: the attempt to achieve social justice.

Hayek's argument against the "mirage" of social justice is the topic of the articles by Johnston and Lukes. The background to this argument is discussed by Williams: Hayek's conception of liberty. Hayek's understanding of liberty relies on his distinction between spontaneous orders, governed by open-ended rules, and planned organizations, consciously directed to a specific set of purposes. The main idea of Hayek's political thought is that we are far more indebted to spontaneous orders than our (supposedly) planning-oriented, rationalist heritage recognizes. The advantage of spontaneous

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orders is that they leave scope for individual freedom in choosing ends and fitting means to them, while planned organizations constrain individual purposes and strategies alike. Accordingly, the essential requirement of spontaneous order and, therefore, of liberty, is the rule of law, because it allows no individual or group to plan the activities of anyone else. As Williams points out, this means that legislative democracy plays little or no role in Hayek's Great Society; for the imposition of a certain set of ends is no more justifiable, and no less coercive, if it is willed by a majority than by a minority.

The neat dichotomy of spontaneous order versus deliberate "organization," market versus democracy, and thus freedom versus coercion, is undermined by Gus diZerega's article, which attributes spontaneous, self-organizing properties not only to the market, the common law, and language, as Hayek did; but to science, nature, and democracy itself (cf. diZerega 1989). (This is only diZerega's starting point; from it, he draws further troubling lessons for classical liberals.) Johnston, too, blurs the sharp line Hayek tries to draw between spontaneous and planned orders, noting that spontaneous orders are dependent on consciously directed organizations (governments), and that organizations that deliberately attempt to counter the uncertainty capitalism brings in its wake are natural outgrowths of the spontaneous order of the market.

Hayek's opposition to the very concept of social justice is part of his effort, judiciously analyzed by Williams, to limit democracy and thereby protect liberty. For social justice is the goal the modern left invokes in opposition to capitalism. Hayek claims that in doing so, the left misses the spontaneous nature of capitalism. Since it is unplanned, capitalism cannot legitimately be the object of a concept such as justice, which presupposes intentionality. Lukes carefully inspects this argument and then demolishes it.

With Johnston, Lukes also points out that Hayek's opposition to making judgments about the justice of capitalism flies in the face of his own apparently utilitarian endorsement of it for producing more wealth than the alternatives. This is what Roland Kley, in the book Legutko reviews below, calls Hayek's "instrumentalism." By judging capitalism in light of its effects—according to Kley, Johnston, and Lukes—Hayek makes capitalism instrumental to good ends rather than being valuable in itself.

Legutko, though, denies that Hayek is an instrumentalist, since this would mean that Hayek is actually concerned about economic

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efficiency when he discusses individual liberty. One could go farther: even Hayek's positive evaluation of wealth might be consistent with an essentially libertarian, rather than utilitarian, perspective. For Hayek often says that wealth gives people the freedom to pursue their own ends in their own ways (within the limits set by the rules of the market). As Williams and Johnston emphasize, in saying this, Hayek contradicts his official, "negative" definition of liberty; for in praising capitalist productivity as enhancing freedom, he equates freedom with people's power to do as they wish, not merely with their mutual noninterference (cf. Gamble 1996, 42). Indeed, as several of our authors point out, Hayek is fond of repeating the Lockean and Smithian argument that the poorest member of a capitalist society is richer than the most powerful king of a primitive society. Here is what we might call Hayek's Rawlsian moment—for it anticipates John Rawls's "difference principle," which requires that such "primary goods" as wealth (the means to a host of freely chosen individual ends) be distributed to the benefit of the least advantaged in a given society.

In this aspect of his thought, Hayek may be deviating from utilitarianism; but is he, for all of that, any less of an instrumentalist? If he does not make capitalism instrumental to happiness, he does make it instrumental to freedom. Thus, he cannot very well disallow, on principle, evaluations of its instrumentality to other ends, such as equality. Nor can Hayek fall back on the view that what is at stake between him and the left is an irreconcilable clash over whether liberty or equality is the ultimate value. For what the left values is *equal liberty*: that is, equal freedom to pursue one's ends as one wishes. Liberals and socialists are united around the importance of individual freedom—all individuals' freedom. So it will not do to rule out the socialist, or even the interventionist, road to freedom on liberal philosophical grounds.

Hayek's attack on the idea of social justice should be seen as the attempt to provide those grounds; it fails, both on its own terms and because of its inconsistency with Hayek's own liberal instrumentalism. There remains the matter of its inconsistency with Hayek's other, utilitarian moment. Hayek's endorsement of capitalist productivity as a means to the end of human freedom opens the door, in principle, to Rawlsian redistributionism;[3] what of Hayek's endorsement of capitalism as instrumental not to freedom, but to happiness?

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Hayek often remarks that "much of our population would suffer and die" if true socialism were to be implemented, so disastrous would its economic effects be (e.g., Hayek 1988, 120). More positively, Hayek defends market exchange as "increas[ing] the satisfaction of human needs from available resources" (ibid., 97). In such passages as these, Hayek remains true to the Enlightenment utilitarianism (see Hazard 1963) out of which economics emerged.

Conversely, in a striking passage in *The Constitution of Liberty*, Hayek writes, of economic progress, that while it "makes us wiser men" by revealing previously undiscovered knowledge, "often it also makes us sadder men." For

> though progress consists in part in achieving things we have been striving for, this does not mean that we shall like all its results or that all will be gainers. And since our wishes and aims are also subject to change in the course of the process, it is questionable whether the statement has a clear meaning that the new state of affairs that progress creates is a better one. Progress in the sense of the cumulative growth of knowledge and power over nature is a term that says little about whether the new state will give us more satisfaction than the old. The pleasure may be solely in achieving what we have been striving for, and the assured possession may give us little satisfaction. The question whether, if we had to stop at our present stage of development, we would in any significant sense be better off or happier than if we had stopped a hundred or a thousand years ago is probably unanswerable. (Hayek 1960, 41)

However, one notices that what at first seems an admirable utilitarian attempt to grapple with the dark side of capitalism imperceptibly turns, in the space of these few lines of text, into a rejection of the possibility of such an attempt. By moving, self-contradictorily and without justification, from the declaration that economic progress, and therefore capitalism, produce some measure of unhappiness to the claim that the question of whether it does so is unanswerable, Hayek passes up the chance to engage in an (admittedly difficult and open-ended) inquiry into whether, in terms of human well-being, the balance sheet on capitalism is, in fact, positive. After making this move, Hayek is able to produce the following blanket endorsement of the effects of capitalism:

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> The answer, however, does not matter. What matters is the successful striving for what at each moment seems attainable. It is not the fruits of past success but the living in and for the future in which human intelligence proves itself. Progress is movement for movement's sake, for it is in the process of learning, and in the effects of having learned something new, that man enjoys the gift of his intelligence. (Ibid.)

In short: we need not deal with difficult psychological questions because we know beforehand that capitalism happens to maximize the true source of human well-being: the opportunity for individual striving.

Ironically, this claim may not be so far wrong. In *The Joyless Economy* (1976), Tibor Scitovsky's analysis of the empirical literature on human happiness suggests that boredom is as unpleasant as pain, and that moving from either pain or boredom toward a state of satisfaction is itself more pleasant than the achievement of that state. (See the special issue of *Critical Review* devoted to Scitovsky's book: vol. 10, no. 4.) If there is an argument for capitalism on utilitarian grounds, it might well be that the capitalist struggle is more stimulating and fulfilling than the torpor of even an efficiently functioning welfare state. But Hayek formulates this thesis dogmatically, failing to allow—let alone investigate—the possibility that, as he initially admits, capitalism is a mixed blessing. It is difficult to interpret this strategy as anything but an attempt to foreclose the type of questioning of capitalism with which the passage begins. Here, as so often in Hayek's political philosophy, he moves much too quickly away from the uncertain, disputable case for capitalism one might derive from Austrian economics toward a dogmatic, airtight ideology that would be immune to doubt.

As Gamble notes (of the "road to serfdom" argument), Hayek proceeds "primarily on a priori theoretical grounds" (1996, 24). Kley suggests a credible explanation for this apriorism: Hayek's instrumentalism, according to Kley, "runs out of steam and is unable on its own to settle important questions a liberal theory must answer" (1994, 12). That is, if Hayek is to vindicate *classical* liberal, antigovernment answers to such questions—and if he is to do this in a manner that can withstand the incessant challenges to classical liberalism allegedly thrown forth by constructivist rationalism—then he must find an a priori, philosophical basis for classical liber-

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alism. Hayek's original impetus to support capitalism on economic grounds is not enough, for as both Johnston and Lukes point out, one cannot derive an a priori condemnation of income redistribution from the epistemological argument for markets contained in Austrian economics. Boettke's essay explains why: Hayek's economics provides no barrier to *any* policy scheme a priori, for it is its resolute empiricism that makes Hayek's ideal-type use of equilibrium constructs superior to aprioristic mathematical formalism. This is not to say, of course, that Hayek's economics—for instance, his theory of the trade cycle—does not contain strong indictments of certain forms of state action. But these arguments against particular interventions should be seen as depending on empirical confirmation of their applicability in a particular time and place, as well as on the magnitude of the negative effects of these interventions—which might, in a given instance, be outweighed by their positive effects.[4]

To prevent the state from engaging in income redistribution, then, Hayek had to find philosophical, not economic, arguments. These arguments, according to the contributors to this issue, fail. Does this mean that there is no merit in Hayek's work? Not at all. On the one hand, Hayek's failures are instructive: they warn us that scholarship can easily become ideology, and that a sure sign of this transition is apriorism. On the other hand, there remains Hayek's success: his economics. There, on a posteriori grounds, those who are genuinely interested in comparing the costs and the benefits of capitalism would do well to begin building.

NOTES

1. In chapter XII of *The Road to Serfdom* Hayek presents extended quotations establishing that some proto-Nazis were nationalists and antiliberals—but that was never in doubt. What is implausible is the explanation he seems to be suggesting for why nationalism and antiliberalism were so appealing: namely, that they were means to the end of installing government economic planning. Here, as always in his efforts to trace the intellectual history of "constructivist rationalism," Hayek's viewpoint is so narrowly economistic (and intellectualistic) that he interprets all thinkers as being primarily motivated by their understanding of the source of social order—Is it planned or is it spontaneous?—overlooking the tangential nature of this question for most people, even most intellectuals. For more plausible interpretations of Nazism, see, to mention but a few masterpieces in the vast literature, Stern 1961, Mosse 1964, Jäckel 1972, and Goldhagen 1996. Cf. Neaman 1995.

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2. We still lack a competent critical treatment of Hayek's attempt, most prominently in *The Counter-Revolution of Science*, to blame socialism on Comte and Saint-Simon. (Nor do we have an assessment of the accuracy of his interpretation of Comte and Saint-Simon as shaped primarily by "constructivist rationalism.") This thesis is, however, *prima facie* implausible given: (1) Hayek's admitted inability to understand Hegel (Hayek 1952, 376), hence Marx—which explains his resort to recitations of superficial similarities between Hegel and Comte; (2) the striking similarities between Hayek's antirationalism and contemporary leftist postmodernism (see Friedman 1994, 494–95), belying Hayek's convictions that the left, and contemporary thought more generally, are characterized by a "preference . . . for everything that is done 'consciously' or 'deliberately'" (Hayek 1973, 11); and (3) the possibility, never (as far as I know) addressed by Hayek, that the recourse to government intervention, thence to planning, is not a mysterious fallacy that requires historical explanation, but is simply a commonsensical response to social problems: one turns for help to the most powerful available agency, which in modern times is the state. On the first point, compare *The Counter-Revolution of Science* to Hayek's more judicious understanding of Marx in *The Road to Serfdom* (eight years earlier)—where he seemed to recognize that Marx was not, in fact, in favor of "organization" as much as "freedom" (1944, 171). On the third point, consider that, as an economist of the type Boettke discusses, Hayek was so insightful about the merits of imperfect markets that he may sometimes have forgotten precisely how counterintuitive his insights were. In positing the need for an intellectual-history explanation for interventionism, Hayek assumes that people would only support interventionism if they had been indocrtinated with a planning mentality, while a more parsimonious explanation for that mentality is that it is people's default option when they have not been introduced to economic theory of the sort Hayek espoused.
3. It should be noted that Rawls's theory of justice only demands redistribution of income by the state when this would serve the interests of the least advantaged. Thus, determining whether there should be state-sponsored redistribution is an empirical question whose answer depends on its effects; and one can readily imagine that Hayekian economics and Schumpeterian, skeptical political science could be combined to make the case against answering it in the affirmative very often (see Schumpeter 1950, 256–64). Indeed, the most effective engine of Rawlsian redistribution the world has ever seen may well be economic globalization, which is improving the lot of the least advantaged by shifting production to the Third World—despite, not because of, the efforts of governments. Thus, Rawlsian liberalism can, in principle, lead as easily to laissez faire as to the welfare state, especially when one does not take the arbitrary borders of nation-states to represent the outer limits of concern for the least advantaged.
4. Whether Hayek recognized the empiricist, even historicist implications of his use of equilibrium as an ideal type is another issue.

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Peter J. Boettke

WHERE DID ECONOMICS GO WRONG? MODERN ECONOMICS AS A FLIGHT FROM REALITY

ABSTRACT: *F. A. Hayek's realistic economic theory has been replaced by the formalistic use of equlibrium models that bear little resemblance to reality. These models are as serviceable to the right as to the left: they allow the economist either to condemn capitalism for failing to measure up to the model of perfect competition, or to praise capitalism as a utopia of perfect knowledge and rational expectations. Hayek, by contrast, used equilibrium to show that while capitalism is not perfect, it contains error-correcting institutions that bring it closer to perfection than is intuitively apparent.*

On March 1, 1933, F. A. Hayek delivered his inaugural lecture at the London School of Economics and Political Science. Hayek, recently appointed to the Thomas Tooke Chair in Economic Science and Statistics at the LSE, sought to explain the trend in public opinion toward economic interventionism, embodied in the para-

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dox that questions about economic matters were asked more frequently than questions related to any other academic discipline, even while the answers economists gave were largely disregarded by a skeptical public.

The cause of this paradox, according to Hayek, was twofold. First, the teachings of economics are counterintuitive. (Who would intuit that a law to raise wages might instead cause unemployment?) Second, these teachings expose as utopian many commonsensical solutions to concrete problems. "The existence of a body of reasoning which prevented people from following their first impulsive reactions, and which compelled them to balance indirect effects, which could be seen only by exercising the intellect, against intense feeling caused by the direct observation of concrete suffering, then as now, occasioned resentment" (Hayek 1933, 21).

This resentment, Hayek argued, coupled with recent re-examinations of the analytical foundations of classical economics, had provided fertile ground for the German Historical school to rise to prominence among economists. The German school, along with American Institutionalism, offered a method for the practical-minded economist that did not possess the frustrating features of classical analytical economics. A body of thought that justified treating economic problems as unique—and their solutions as unbound by economic principles—was welcome relief for the would-be economic reformer.

The full effect of this trend, Hayek argued, was only being felt within the second generation of economists subject to its influence. The first generation, while rejecting the analytical method of classical economics, was nevertheless trained in it. Although they tried to shake off the rigorous logic of the classical school, economists trained in that way of thinking could not fully escape its influence. The second generation, however, not trained in the classical method, lacked the mental tools necessary to interpret economic phenomena in a theoretically coherent manner.

Hayek's argument can cut two ways, as I will try to demonstrate throughout this essay. On the one hand, Hayek was certainly right to suggest that the attempt to reject economic theory in the name of "realism" was inimical to satisfactory economics. We have no choice but to think in terms of models and simplifying assumptions. The world would be too complex to understand otherwise. But, on the other hand, the proposition that all thought is framed

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by theoretical concepts (whether consciously or unconsciously adopted) and, as a result, that all facts are theory-laden, does not license the adoption of any and every theory. Some theories are better than others. Hayek left this side of the argument unexamined. For his purposes, it was enough to contrast theory with Historicism and maintain that theory is essential for proper economic analysis and public policy application.

Internal coherence is one way of adjudicating among theories, but so is correspondence to everyday life. Too much realism may kill analysis, but too little realism is unscientific. If theoretical coherence alone were all that mattered, then the only constraint on theoretical exercises would be the human imagination. Interesting puzzles would replace pragmatic solutions to problems encountered in the world—arguably, an accurate characterization of most contemporary economic theory. Economists must steer a course between (allegedly) pure description and the mere recording of events, on the one side, and self-indulgent mental gymnastics on the other. In 1933, Hayek addressed himself only to the problems associated with putatively unvarnished historical description.

The task of the economist, according to Hayek, was to construct from familiar elements, gleaned from our everyday experience in the world, a mental model aimed at reproducing the workings of the economic system. This task was misunderstood by economists of his day, he argued, because the self-organizing principles of the market economy were no longer understood. These principles were the great contributions of classical economics. But by the time neoclassical economists responded to the Historicist challenge by developing marginal analysis, it had been too late. The generation of economists now entrusted with designing public policy had lost an understanding of the basic properties of the market system. As a result, the trend in economic thinking was biased toward government planning of the economy. This trend was not only reflected in the growing interest in socialism, but could also be detected in the reemergence of arguments for protectionism in international trade and for regulation of the domestic economy.

I. WHERE HAYEK WENT WRONG

Hayek's lecture is of interest to us today mainly for its early statement of themes that later came to dominate his research program.

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As Bruce Caldwell puts it, Hayek's lecture, although entitled "The Trend of Economic Thinking," "is probably best viewed as a suitable point of departure for explicating the trend of *Hayek's* thinking" (Caldwell 1988, 178). Hayek was prescient about the policy direction that would increasingly dominate economic thought, but he blamed the wrong forces for this trend. Historicism and Institutionalism, along with Hayek's own Austrian school of economics, were to be completely displaced by formalism within the decade following Hayek's address. Interventionism and planning would be justified not on Historicist grounds, but on the basis of the most advanced refinements of economic theory and technique that *neoclassical* economics—the very brand of economics Hayek tried to defend—had to offer.

The Austrians' theoretical arguments, however, soon came to be excluded from the canon of neoclassical "theory" by mathematical formalists, even while the empirical investigations of the American Institutionalists and the German Historicists were not considered "empirical" after the parallel development of modern statistical techniques by econometricians (Caldwell 1989). The discipline of economics rejected both the Austrian and the Historicist/Institutionalist traditions of economic thought, yet reached nearly the same interventionist conclusions that the Historical and Institutionalist schools favored.

This was hardly the trend that Hayek detected in his inaugural address at the LSE. Nor was Hayek the only member of the Austrian school about to be blindsided by the direction of economics. Ludwig von Mises wrote in 1933 that there were no substantive differences between the various schools of modern neoclassical economics (Mises 1981, 214). He viewed Austrian economics as squarely within the mainstream of neoclassical thought, the tradition identified by Hayek as yielding propositions that flew in the face of the simplistic intuitive appeal of government intervention and planning. For Mises, much as for Hayek, the enemies of modern economic science were Marxism, Historicism, and Institutionalism. Subtle differences in theory and the mode of its presentation among mainstream neoclassical economic theorists did not matter much, not when compared to this major division. Neoclassical economics—classical economics grounded in marginal utility theory—was scientific; other approaches were pseudoscientific.

Hayek's and Mises's myopia notwithstanding, among neoclassical

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economists the Austrians were indeed different. The Viennese economist Carl Menger and those following in his footsteps emphasized, in addition to subjectivism and marginal utility analysis, the role of knowledge and ignorance, time and uncertainty, change and disequilibrium in understanding economic processes. Austrian and Swedish economists (and a few Americans and Britons, such as Frank Fetter and Philip Wicksteed) aside, neoclassical economists ignored these matters in their theorizing. But because Austrian economists agreed with the mainstream about the value of subjective utility and marginal analysis, they were viewed by the others, and more importantly by themselves, as indistinguishable from mainstream economists who overlooked market "imperfections" such as time and ignorance.[1]

Hayek and Mises failed to see what was coming because the tension between neoclassical and Austrian economics only became acute during two economic debates that had not yet begun: one with John Maynard Keynes over macroeconomic theory and policy, and the other with Oskar Lange over the feasibility and desirability of socialism. Even the debate with Keynes was not, alone, enough to disturb the Austrians' vision of their school's "mainstream" status. In reality this debate revolved around fundamental issues in money and capital theory, but on the surface it was about more superficial questions of public policy. This was obscured, on both sides, by the fact that Hayek's brand of Continental capital and monetary theory was little understood and appreciated in England and America. John Hicks pointed out that while Hayek wrote in English, it was not English economics (Hicks 1967). As a result, many of the analytical issues at stake were never adequately addressed.

Keynes, for example, never successfully responded to Hayek's critique of his *Treatise on Money*, in which Hayek questioned Keynes's tendency to treat real economic factors as aggregates, and criticized Keynes's failure to provide a theory of capital. The debate was a case study in mutual misunderstanding. Since Hayek shared the basically laissez-faire policy conclusions of many classical British economists, Keynes associated Hayek, incorrectly, with the British anti-interventionists' theoretical apparatus—which Hayek had (albeit unwittingly) jettisoned, at least in part. In this manner, Hayek was lumped by Keynes with the "classical" school that was to be overturned by *The General Theory of Employment, Interest and Money*. By the same token, according to the Austrians all that was needed

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to demonstrate the fundamental problems with Keynes was classical economics; for Keynes's *General Theory* was interpreted by Mises and Hayek as a return to the inflationist fallacies of the past (which even crude versions of the quantity theory of money had displaced) and to an economics of abundance, which denied that capital resources were scarce. But here the Austrians were mistaken.[2] Certainly Keynes made fundamental errors in economic reasoning, but in many other respects, he had penetrated classical British economics deeply and had left it in tatters. Appeals to economic orthodoxy were not enough, either rhetorically or substantively, to forestall the rush to embrace Keynesian economics and policy.[3]

The Great Depression not only led to the embrace of Keynesian economics, it also lent new prestige to socialism. Capitalism, critics argued, was both unjust and chaotic. Business cycles were seen as manifestations of the inherent contradictions of capitalism. This message possessed a very practical appeal during the crisis, for obvious reasons.

Nothing in the popular version of this socialism would have shaken the self-image of Austrian economists as members of the economics mainstream. As early as the 1890s, Eugen von Böhm-Bawerk had used neoclassical economic theory to rebut Marx's understanding of the operation of capitalism. In 1920, Mises did the same thing for the idea of socialist economic planning, demonstrating that without private ownership in the means of production, socialist planners could not rationally calculate the alternative uses of scarce resources (Mises 1920 and 1922). But in the 1930s, Oskar Lange used neoclassical equilibrium analysis to demonstrate that Mises's criticism was not valid—if one assumed that perfect knowledge was available to the planners. For in that case, they could calculate the alternative use of resources just as the competitive market supposedly does, through a process of trial and error. Socialist planners would draw on knowledge of supply and demand conditions in the same manner that economic agents within a market economy were pictured as doing in the neoclassical model of the perfectly competitive economy in equilibrium. If this model was theoretically coherent, then Lange's model of market socialism was equally coherent.

Lange's defense of socialism on neoclassical grounds took the Austrians by surprise, as did its acceptance by mainstream economists. Such established figures as Frank Knight and Joseph Schum-

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peter concurred with Lange's assessment of the analytical issue, and younger economists, such as Abba Lerner, began to develop Lange's argument further. In response, both Mises and Hayek started to articulate more clearly and precisely what differentiated Austrian economics from the neoclassical orthodoxy. But by this time they were already too far outside of the mainstream to command its attention any longer. Mises and Hayek came increasingly to be viewed as politically motivated pundits of the right, not as serious economists. By 1950 at the latest, the Austrian school of economics was forced underground—to the extent that, by now, it is questionable whether it should be considered part of the discipline of economics any more. By mid-century Hayek's prediction had came true: interventionism, even socialism, came to dominate economics. But the source of this trend was not antitheoretical Historicism. It was neoclassical theory itself.

II. THE FORMALIST REVOLUTION

In the eyes of professional economists, Austrian economics was soundly defeated by both Keynesianism and neoclassical socialism. Whereas Keynesianism challenged the macroeconomic stability of capitalism, neoclassical socialism challenged its microeconomic efficiency. Lange and Lerner's argument could be interpreted as demonstrating that ideal market socialism could perform as well as ideal capitalism. A stronger interpretation, however, was that in the face of allegedly widespread monopoly power in real-world capitalism, real-world market socialism would be even *more* efficient.

What made the neoclassical mainstream receptive to these ideas was its failure to take seriously such factors as the use of (and imperfections in) economic knowledge, the presence of ignorance and uncertainty, the passage of time, and changes in economic conditions. All of this was assumed away in mainstream equilibrium models. Meanwhile, Austrians continued to uphold the counterintuitive policy conclusions of earlier economic theory because, if one *did* take these factors seriously, new forms of interventionism premised upon perfect knowledge in a timeless, changeless equilibrium seemed utterly fantastic, hence irrelevant.

Austrians, for example, argued that monetary inflation worked its way through the economic system by means of a ragged process of relative price adjustment. Thus, the nominally unimportant effect

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of inflation on money prices could have very real effects on the underlying distribution of resources: relative price signals could become distorted, misleading investors. The injection of money into one sector of the economy could create the illusion of increased real demand there, leading to unneeded new investment. Moreover, investment required resources that, far from being an undifferentiated aggregate, "capital," were both heterogeneous and specific to certain projects. The capital needed to build a house is different from that needed to build a car. Distortions in investment caused by monetary disturbances in the price system could therefore have severe consequences. Blinded by its maintenance of a stable supply of "capital," the government could overstimulate the supply of, for instance, houses at the expense of what consumers actually wanted, such as cars. Mainstream neoclassical economics, however, overlooked these problems either by rejecting the quantity theory of money altogether, as Keynesians did; or else by accepting the Monetarists' crudely mechanical version of it, which took evenly proportionate adjustments in the general price level to be the main consequence of increases in the money supply. The theoretical and methodological work of Mises and Hayek, which emphasized processes of adjustment to real-world changes in the "data" that the mainstream saw as given and unproblematic, appeared anachronistic to economists whose attention was focused on an imaginary state of equilibrium, whether perfect or imperfect (i.e., marred by unemployment).

In 1947, the gap between the Austrians and the mainstream of neoclassical economics was widened by the publication of Paul Samuelson's *Foundations of Economic Analysis*.[4] Samuelson pioneered a synthesis of neoclassical and Keynesian economics, as well as endorsing the Lange-Lerner argument for market socialism.[5] Samuelson also furthered the neoclassical case against the free market in the 1950s, with his development of the theory of market failure.

Previously, the model of a perfectly competitive market was primarily used in thought experiments designed to be contrasted with real-world market institutions. Such counterfactual thought experiments illuminated the positive function of those institutions (e.g., Knight 1921). In a world of complete information, for example, neither firms nor profits would logically exist. Therefore, the constrast of this imaginary world against the real world of firms and

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profits showed that such institutions may have some functional significance in coping with *im*perfect and *in*complete information.

This counterfactual use of the theory of perfect competition was reversed by the formalist revolution in economics.[6] The departures of reality from the model of perfect competition were now thought to highlight interventions in the market economy that would be necessary to approximate equilibrium. Competitive equilibrium and the maximizing behavior that would ideally produce it represented the hard core of the research program of economists from 1950 on. As this happened, economics as a discipline was transformed.[7]

The central role the model came to play was independent of whether it was employed by the minority who thought the market economy approximated the model, or the majority who thought that capitalism deviated significantly enough from the model that a great deal of government intervention was justified. In both cases, formalism led to utopianism. Either (in the minority view) reality was idealized, so that it approximated the model; or (in the majority view) reality became a dystopia, devoid of dynamic adjustment properties, and utopian properties were inadvertently attributed to interventions designed to make reality match the model. Absent from both types of formalism was recognition of any possibility other than all or nothing. Either the real world exemplified static equilibrium, or it could not approach that state without a push from the state. The intermediate possibilities represented by real-world institutions of adjustment to disequilibrium became invisible because the model contained only equilibrium.

Competitive equilibrium required: (1) perfect information, (2) large numbers of buyers and sellers, and (3) costless mobility of resources. Under this set of restrictions, the logic of the model determined (4) that each market participant would treat prices as given, and (5) that prices would equal the marginal costs of production. As a result, firms would produce at minimum average cost and earn zero economic profits. In the 1950s and 1960s, mainstream theory produced two fundamental welfare theorems that followed from proofs of the (mathematical) existence and stability of this competitive equilibrium. The first welfare theorem stated that an economy in competitive general equilibrium was Pareto efficient. The second theorem stated that any desired Pareto-efficient economy could be achieved through the decentralized market mechanism. Together,

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these two welfare theorems prove that *if* the appropriate conditions hold, the market mechanism yields the best possible economy.

That, however, is a big *if*. Without perfect futures markets, for example, intertemporal allocations could not be assumed to be optimal. Unless the strict conditions required for general competitive equilibrium were met, the economic theorist could not with any confidence make pronouncements about the efficiency of market allocations. In fact, she could be confident that the market would yield suboptimal results that demanded corrective government action.

The new role played by competitive equilibrium was fostered by Samuelson's methodological innovations. Samuelson sought to rewrite economics into the language of mathematics so as to eliminate the vague assumptions that underlay debates among "literary economists" of previous generations. Restating economics in the axiomatic language of mathematics, Samuelson argued, would force economists to make explicit assumptions that they had previously held implicitly. But the techniques of mathematics available to Samuelson required well-behaved and linear functions; otherwise, results would be indeterminate and the promised precision would not be achieved. In order to fit economic behavior into mathematical language, the real world had to be drained of its complexity. The problem situation of economic actors had to be simplified drastically so as to yield the precise formulations Samuelson sought.

Samuelson's research program eliminated the conscious component from the economic choices facing individuals in a world of uncertainty. Choice was reduced to a simple determinate exercise within a given ends-means framework, something an automaton could master. The task of discovering not only appropriate means, but also which ends to pursue, was left out of the equation. Moreover, it was forgotten that market institutions and practices arise in large part precisely *because* of deviations from the perfect-market model. Just as the friction between the soles of our shoes and the sidewalk enables us to walk, the imperfections of the real world give rise to the essential institutions and practices that make economic life possible. The complexity of both institutions and individuals is impossible to model precisely, so it was pushed aside by simplifying assumptions.

The huge gap between the older view preserved in Austrian economics and the new use of equilibrium models can be illus-

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trated by considering the reception of Ronald Coase's work on transaction costs. Viewed as a practitioner of counterfactual thought experiments, what Coase was focusing on (in both his 1937 paper on the theory of the firm and his 1960 paper on the problem of social costs) was the origin of actual market and legal institutions as mechanisms for coping with real-world positive transaction costs (see Coase 1988). Without transaction costs, Coase argued in 1937, there would be no need for firms. Transactions in spot markets would be all that would be necessary to coordinate production. In addition, without transaction costs, Coase argued in 1960, there would be no need for property law. Voluntary negotiations between economic actors would resolve all conflicts over property rights. The actual existence of firms and the law can be seen, therefore, as evidence of the ubiquity and intractability of transaction costs.

Coase's project, however, has been largely misunderstood by formalist neoclassical economics. Instead of highlighting the functional significance of real-world institutions in a world of positive transaction costs, Coase's work has been interpreted as describing the welfare implications of a zero-transaction-cost world. The "Coase Theorem" has been taken to hold that in a world of zero transaction costs, the initial distribution of property rights does not matter; for as long as individuals are free to transact, resources will be channelled toward their most highly valued use.[8]

Coase's theoretical insights into the role of institutions of property and contract, however, were not all that was buried by the formalist revolution. Historical work on the complex web of institutions that undergird capitalist dynamics produced by the earlier generation of neoclassical scholars, such as Knut Wicksell, Frank Knight, and Jacob Viner, as well as Mises and Hayek, was swept aside in the rush toward formal theorizing. The real problem with the trend in economic thinking in the 1930s and 1940s was neither the critique of theory carried on by Historicism and Institutionalism, nor the war against classical liberalism launched by Keynesians and socialists. The antitheoretical stance of Historicism and Institutionalism was self-defeating, and Keynesianism and socialism would rise and fall with the tides of politics. The real problem for economics was that the medium was becoming the message, as the strictures of formalism denied scientific status to *realistic theory*.

Ideas that defied the techniques of formal analysis came to be considered unworthy of serious consideration. Even when an idea

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was thought to be interesting, if it could not be translated into an appropriate model, there was not much that could be done with it.[9] The substance of economics was displaced by mathematical technique, and fundamental economic knowledge was set back—despite the obvious progress made in the precision with which economists could say what was left to say.[10]

The first casualty of the formalist revolution was the historically and institutionally rich tradition of economics still evident in the 1930s. Case studies of particular industries, for example, had been common. After the development of econometrics, however, the case-study approach was discarded in favor of large-sample data analysis. The second casualty of the formalist revolution was what might be called "the economist's way of thinking," the defining characteristic of the discipline in both its classical and early neoclassical renditions. The best of the earlier economics combined an appreciation for the particularities of institutional context with theory grounded in the generalities of choice under conditions of scarcity. Individuals always face tradeoffs, in this view, but the manner in which they weight their choices is contingent upon the particular context of choice.

Samuelson drained economic theory of institutional context, and the econometric approach to empirical economics eliminated historical detail. Parsimony won out over thoroughness. Economics moved at this time from one side of the cultural divide (the liberal arts) to the other side (the sciences)—or at least that was the self-image of economists, who equated science more with precision than accuracy. The physicist does not allow the impossiblity of making accurate predictions in many real-world contexts (such as meteorology) interfere with her pursuit of the precise formal laws that govern them. By myopically pursuing only the formal aspects of the discipline, economics was reduced to its present state, in which we continually know more and more about less and less.[11]

III. EQUILIBRIUM: DESCRIPTION OF REALITY, NORMATIVE CRITIQUE, OR IDEAL TYPE?

In light of the formalist revolution in economic theory, we can usefully distinguish the older use of the equilibrium model as an *ideal type* from its use by free-market Chicago-school economists as a

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description of reality, as well as its use by interventionist Neo-Keynesians as a critical standard with which reality could be indicted when it failed to measure up. In the latter two uses of equilibrium, it constitutes a static ideal, and the question is whether reality does or does not match it. In the ideal-type use, by contrast, the question is how departures from the ideal type—denied by the Chicago school; equated with market "failure" by Neo-Keynesians—may constitute forms of incomplete success. An ideal type is neither intended to describe reality nor to indict it. It is instead a theoretical construct intended to illuminate certain things that *might* occur in reality; empirical investigation determines whether these phenomena are actually present and how they came to be there.[13] In this view, disequilibrium is not necessarily a market failure; something less than perfection may yet be better than any attainable alternative.

Deployed as an ideal type, equilibrium analysis allowed economists to describe what the world would be like in the absence of imperfections such as uncertainty and change. The descriptive value of the model lay precisely in its departure from observed reality, for this underscored the function of real-world institutions in dealing with *imperfect* knowledge, uncertainty, and so forth. Equilibrium was used as an ideal type by such Austrian economists as Mises and Hayek; early Chicago-school theorists, such as Frank Knight; LSE theorists, such as Coase; and Swedish-school theorists, such as Knut Wicksell. By contrast, economic formalism was, at first, virtually defined by the use of equilibrium as a standard for criticizing reality that, on the one hand, ignored its dynamic elements and, on the other, assumed that static perfection must (somehow) be attainable. Samuelson, Kenneth Arrow, Frank Hahn, and more recently Joseph Stiglitz are the major theorists who have employed equilibrium models in this manner.

Almost simultaneously with the emergence of equilibrium as an *indictment* of reality, University of Chicago economists such as Milton Friedman, George Stigler, Gary Becker, and Robert Lucas began to use it as a *description* of reality. In their view, real markets come breathtakingly close to approximating the efficiency properties of general competitive equilibrium. And even if a real-world market deviates from the ideal, the predictions of the model approximate behavior in the real world better than alternative models do. Real-world markets, in other words, act "as if" they were in

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competitive equilibrium. In fact, Becker and Lucas treat the existence of equilibrium as an explicit core *assumption* of their analysis of economic phenomena. By collapsing the gap between the model and reality, the Chicago school in its purest form does away with the need for intervention of the sort advocated by Samuelson et al. Hence the current reputation of laissez faire as a wildly unrealistic economist's dogma. In comparison with the implausible assumptions of Chicago-school laissez faire, government regulation has come to be seen not as a utopian outgrowth of crude, "intutive" economic thought, but as a form of hard-headed realism.

From the perspective of those who see equilibrium as an ideal type, both its empirical idealization and its use as an indictment of a static reality appear deficient. The Chicago school's use of equilibrium to describe reality conflates the mental and empirical worlds. And while those who use equilibrium to indict reality recognize that the world is not perfect, their ignorance of the ways imperfect institutions do produce a semblance of economic order gives them an unduly pessimistic view of the market, and an unrealistically optimistic tendency to rely on legal fiat to bring reality up to par. *In both cases, the heuristic value of equilibrium is sacrificed.* By ignoring the dynamics of disequilibrium, both traditions obscure the possibility that real-world market institutions may have coordinative properties *even in the presence of* dispersed knowledge, pervasive ignorance, the irreversibility of time, and changing conditions.[14] While the descriptive use of equilibrium readily leads to an endorsement of market transactions, it does so on an unrealistic basis. The proof is that the Chicago school lacks a theory explaining *how* markets achieve whatever degree of success they do; all the important work, as critics never tire of pointing out, is done by the model's assumptions. Similarly, the use of equilibrium as an indictment of reality fails to allow that existing imperfections may, in a dynamic world, be a source of motivation and learning that leads to the correction of market errors.

Both predictive and normative uses of equilibrium portray markets as essentially static. This constitutes an unwitting rejection of the heart of Hayek's contribution, despite the lip-service often paid by formalist economists to his seminal essays on "Economics and Knowledge" (1937) and "The Use of Knowledge in Society" (1945).[15]

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IV. "INFORMATION" AS A BRIDGE TO REALITY

The central concern of economics, Hayek suggested, is to explain "how the spontaneous interaction of a number of people, each possessing only bits of knowledge, brings about a state of affairs in which prices correspond to costs, etc., and which could be brought about by deliberate direction only by somebody who possessed the combined knowledge of all those individuals." Economic theory, in other words, should explain observed reality. The empirical observation that prices do *tend to* correspond to costs is the starting point of economic science. But formal neoclassical theory, instead of discerning how diffuse information is processed and used by imperfect economic actors, falls "back on the assumption that everybody knows everything" and so evades "any real solution of the problem" (Hayek [1937] 1948, 50–51).

Hayek went further, arguing that the kind of knowledge that is dispersed among market participants is "knowledge of the kind which by its nature cannot enter into statistics" (Hayek [1945] 1948, 83). The content of market prices is not the sort of information that can be treated as a commodity. It is not, therefore, the *costliness* of information that is essential to Hayek's story, but rather its *dispersal*. Its dispersal makes economic knowledge inaccessible except under special, institutionally fragile, circumstances. The relevant economic knowledge, as Hayek put, is knowledge of "particular time and place" (ibid., 80). It can only be used and discovered in particular institutional contexts—contexts that are abstracted away in the timeless, placeless formalism of equilibrium modelling. Hence the irrelevance of contemporary economics for comparing the effects of alternative real-world institutional arrangments on actual economic performance.[16]

The fundamental purpose of economic analysis, once Hayek's view of economic knowledge is accepted, is to determine how a dynamic system of production utilizes dispersed knowledge of time and place in a manner that aligns production plans with consumption demands. The money-price system, within an institutional environment of well-defined and enforced private property rights, serves this aligning function in at least three ways. First, *ex ante*, prices transmit knowledge about the relative scarcities of goods to various market participants so they may adjust their behavior accordingly. If the price of a good goes up, this informs economic ac-

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tors that the good has become relatively more scarce and that they should economize on its use. For this reason, participants in the market have an incentive to include the knowledge contained in prices in their actions *over time*. Second, the price system serves the *ex post* function of revealing the ultimate profitability or unprofitability of economic actions. Prescient entrepreneurship (in the broad sense of the term) is rewarded with profits; errors are penalized by losses. Market prices, therefore, not only motivate future decisions by conveying information about changing market conditions, but also help market participants evaluate the appropriateness of past market decisions and correct erroneous ones.

Seen in this light, the market process is a matter of *dynamic adjustment*. What is it adjustment *to*? It is, in effect, adjustment to the gaps between a static equilibrium of universal satisfaction and the many departures from this model that are present in the real world. Each of these gaps between the counterfactual and the factual represent a profit opportunity. Price *information* is also *motivation* for profitable real-world adjustment, over time, to the profit opportunities of a particular place.[17]

Formal equilibrium theory contains only a distorted, static image of these aspects of the price system. As they came to recognize this deficiency in mainstream neoclassical economics, Hayek and others in the Austrian tradition sought to explain how the price system works in real-world disequilibrium.[18] The Austrian critique of the standard model is that it has no place for the multifaceted role that *disequilibrium prices* serve within the market process.

The very idea of an economic theory of the market *process* stands in contrast to the static nature of equilibrium analysis. Since only an array of *disequilibrium* prices sets in motion the competitive process characterizing real-world markets, the formalist orthodoxy, by its very nature, must ignore this process. As Mises wrote:

> The activities of the entrepreneur or of any other actor on the economic scene are not guided by considerations of any such thing as equilibrium prices and the evenly rotating economy. The entrepreneurs take into account anticipated future prices, not final prices or equilibrium prices. They discover discrepancies between the height of the prices of the complementary factors of production and the anticipated future prices of the products, and they are intent upon taking advantage of such discrepancies. (1949, 329)

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Prices serve as the basis of economic calculation only in the context of a process of competition brought into being by what formalism assumes a way: disequilibrium. Real-world market prices do not perfectly contain all of the relevant information required for competitive equilibrium; if such information were known already, there would be no need for economic activity in the first place. Under disequilibrium conditions, however, the active bidding up of prices when demand exceeds supply, and their bidding down when supply exceeds demand, generates the incentives and information necessary to coordinate economic decisions. The discrepancy between the current array of prices and the anticipated future array of prices provides the incentive for entrepreneurs to discover hitherto-unknown opportunities for economic profit. Of course, in this process of perceiving the future, entrepreneurs may (and do) make errors, but these errors can, by creating further discovery opportunities, generate further activity aimed at allocating or reallocating resources in a more effective manner to obtain the ends sought after. "The market process," Israel Kirzner writes, "emerges as the necessary implication of the circumstances that people act, and that in their actions they err, discover their errors, and tend to revise their actions in a direction likely to be less erroneous than before" (1979, 30). While the assumption of perfect knowledge was essential for modelling the state of competitive equilibrium, it precluded an examination of the path by which adjustment toward equilibrium could be achieved. If the system were not already in equilibrium, one could not explain how it would get there. Omniscience logically results in non-action. A profit opportunity that is known to all can be realized by none. Thus, if it is to be realistic, the model's assumptions have to be relaxed, but then it becomes overly complex and loses its formal elegance.

This dilemma has dogged a significant strand within the mainstream of economic thought that, since about 1960, has tried to take up Hayek's challenge and examine the informational aspect of markets. This research program is of vital importance in evaluating the current state of economics not only because it is the rising orthodoxy at the moment, but because it attempts to grapple with the main feature of reality that, in the Austrian view, is obscured by economic formalism. But because the new economics of information is itself formalist in its use of equilibrium models, it has been

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fated to oscillate between utopianism about the informational properties of real markets and utopianism about the alternatives.

Classical economics had focused exclusively upon the incentive to purchase more or less of a particular good that prices provided. The new economists of information recognize that prices serve a communicative function as well. They see that prices transmit vital knowledge about (for instance) relative scarcities, enabling economic participants to coordinate their decisions. Chicago's George Stigler is usually credited with being the first economist to develop an informational model consistent with standard neoclassical price theory. Stigler (1961) argued that individuals will optimally search for the information necessary to accomplish their goals in the market, but unlike Hayek, he assumed that they will do so in an optimal manner by comparing the marginal cost of information with the marginal benefit of continuing to search for it. In other words, Stigler joined the informational content of markets with the assumption that equilibrium models should be seen as describing actual behavior. In Stigler's view, there was economic ignorance in the real world, but it was the optimal level of ignorance. The attempt to eliminate the remaining ignorance would entail searches for information that were more costly than the benefits they could produce.

Following Stigler, economists such as Armen Alchian and Jack Hirshleifer developed information-search models in which various aspects of the economic system such as advertising, middlemen, unemployment, queues, and rationing take on a new meaning and functional significance.[19] At the same time, economists who treated equilibrium as a critical norm rather than a reality, such as Kenneth Arrow, Leonid Hurwicz, and Roy Radner, also sought to develop models that accounted for informational imperfections.[20] Where Stigler's approach extended the assumption of maximizing behavior to the information-search process, predicting that markets would see various practices emerge to economize on the search process and generate an optimal flow of information, the Arrow/Hurwicz/Radner approach argued that in the face of incomplete information, maximizing agents would be unable to coordinate their behavior with others in an optimal manner unless an appropriate mechanism could be designed anterior to the market.[21] The first approach presupposed the efficiency of market allocations, the second their inefficiency and the prevalence of market failure. Neither

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approach adequately dealt with disequilibrium or the multi-informational components of market processes that help economic actors adjust to and learn from disequilibrium.

Among contemporary economists, Joseph Stiglitz and Sanford Grossman have elaborated the second approach more systematically than anyone else. Their research on the informational role of prices has led to a fundamental recasting of many basic questions in orthodox economic theory.[22] Grossman and Stiglitz understand Hayek to be arguing that prices are "sufficient statistics" for economic coordination, and they conclude that this argument is flawed. In situations where private information is important, they contend, market prices will be informationally inefficient, for the market will not provide the appropriate incentives for information acquisition; thus, the case for economic decentralization is not as theoretically strong as Hayek suggests.

Grossman and Stiglitz's reasoning, however, begs the question against Hayek by starting from the unrealistic assumption of rational-expectations equilibrium. Given this assumption, they maintain, prices will reveal information so efficiently that no one could gain from the revelation of privately held information.[23] Individual agents can simply look at prices and obtain free what would be costly to acquire privately. This free riding leads to an underproduction of information by the market. Prices, as a result, will necessarily fail to reflect all the available information. Grossman (1976, 585) states the supposed paradox as follows:

> In an economy with complete markets, the price system does act in such a way that individuals, observing only prices, and acting in self interest, generate allocations which are efficient. However, such economies need not be stable because prices are revealing so much information that incentives for the collection of information are removed. The price system can be maintained only when it is noisy enough so that traders who collect information can hide that information from other traders.

This paradox does challenge Stigler's model of information searching, as well as the traditional welfare theorems of general competitive equilibrium when they are viewed as describing the decentralized price system. But long before Grossman and Stiglitz, Hayek recognized that the first and second welfare theorems provided neither an accurate description of how actual market

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processes coordinate economic plans, nor of how the institutional environment of the decentralized market generates desirable consequences. Hayek suggested that economists redirect their research program to emphasize the use of dispersed knowledge and the impact of alternative insitutional arrangements on learning. Hayek's theoretical criticisms of standard welfare economics, though, are largely obscured by Grossman and Stiglitz's analysis because it translates Hayek's view of dispersed knowledge into the language of modern formal information theory. This leaves out questions of the *context* and the *tacit dimension* of knowledge.

The economic problem, Hayek emphatically stated, was *not* that posed by standard welfare economics, namely the allocation of scarce resources among competing ends.[24] This way of stating the problem—which leads the neoclassical mainstream to regard general equilibrium as a solution—"habitually disregards" essential elements of the phenomena under investigation, according to Hayek, by ignoring "the unavoidable imperfection of man's knowledge and the consequent need for a process by which knowledge is constantly communicated and acquired." Equilibrium theorizing is not to be rejected, according to Hayek, but its real purpose must be constantly kept in mind. Formal modeling can be a very good servant, but a poor master; unless we remember that the situation the model describes has little direct relevance for the solution of practical problems, it can lead to mistaken judgement. Hayek constantly reiterated that the equilibrium model "does not deal with the social process at all and that it is no more than a useful preliminary for the study of the main problem" (1945 [1980], 78, 91).

The essence of the coordinative property of the price system lies not in its ability to convey perfectly correct information about resource scarcity and technological possibilities, but in "its ability to communicate information concerning its own faulty information-communication properties" (Kirzner 1985, 196). Disequilibrium relative prices, imperfect as they are, nevertheless provide some guidence in error correction and avoidance. This dynamic process of error detection and correction is absent from formal models of economic "information" premised on static equilibrium.

The informational role of prices goes to the heart not only of Hayek's challenge to economic orthodoxy, but of the particular issue that led Hayek to launch this challenge: the debate over socialism.[25]

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V. SOCIALISM REVISITED

Mises began the debate by pointing out that unlike socialism, capitalism could rely on the information and incentives of the private property order that are manifested in the practice of "economic calculation" based on market prices. Eventually the debate led Hayek to realize that the neoclassical mainstream, as embodied in the socialist economists, was treating economic knowledge as given—not in need of discovery by entrepreneurs. This error is revived by the new information economics, in the sense that it does not recognize the possibility of genuine ignorance. Both the laissez-faire Stigler and the interventionist Stiglitz (et al.) treat knowledge "as if" it exists on a bookshelf, so that the only question is whether it is in one's interest to pull it off the shelf or communicate it accurately to others. Searching for existing, already discovered information is important, but it is not the activity captured in economic calculation. Since Grossman and Stiglitz confuse the "informational" role of prices discussed by Hayek with the pregiven information assumed by static equilibrium models, they misconstrue the socialist calculation debate as pitting capitalism, in which prices allocate resources based upon an imperfect arbitrage process, against socialism, in which the allocation of resources is performed by central administrators but will be imperfect because of the cost of monitoring them.

Once Grossman and Stiglitz questioned the informational efficiency of the price system, then some alternative theoretical framework for assessing economic systems was required. Raaj Sah and Stiglitz (Sah and Stiglitz 1985 and 1986) went on to develop an alternative framework for comparing economic systems, continuing the program laid out by Grossman and Stiglitz for examining the comparative costs of different systems of economic coordination. "Informational" questions continue to be at the center of the research agenda, although the focus of comparative assessment is not limited to the informational efficiency of monetary prices.[26]

Armed with their putatively realistic—yet, in fact, static—understanding of economic information, Sah and Stiglitz propose that economists turn to the "quality of decision making" within different organizational structures as the standard of comparison. "How individuals are arranged together affects the nature of the errors made by the economic system," they write (1986, 716). In address-

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ing this issue, Sah and Stiglitz begin by postulating that in a market system, if one entrepreneur fails to pursue a profitable opportunity, it is likely that some other entrepreneur will remedy this failure. In a planned economy, though, the decision by the planning board not to pursue a production project rules out its adoption by anyone else. What impact, then, do market and planned economies have on the ability to choose good over bad production projects?

Suppose we have an urn filled with ping-pong balls, each ball corresponding to a production project. In polyarchical economies (markets) we would expect more of both good and bad projects to be chosen. Hierarchical (planned) economies, on the other hand, will choose fewer good projects, but also fewer bad ones. Therefore, according to Sah and Stiglitz, "the incidence of Type I error is relatively higher in a hierarchy, whereas the incidence of Type II error is relatively higher in a polyarchy" (1986, 719). Type I error means the rejection of a project that should have been accepted, while Type II error is the acceptance of a project that should have been rejected.

While this exercise is theoretically interesting, it does little to explain the way economic systems actually work. In the real world, Type I and Type II errors are linked and omnipresent. Rejecting a project that should have been accepted allows someone to use the resources freed up by this rejection to pursue a project that should have been rejected. The question, then, is what systemic mechanisms can detect errors of both kinds and can provide information and incentives to correct them.[27] "An appraisal of the efficiency of the market process," as Kirzner puts it, "involves an appraisal of the way the market process disseminates [the] missing links of information necessary for the discovery of superior opportunities for the allocation of resources" (1963, 301–302). In making such an appraisal, production projects cannot be treated as essentially known and given. They must be discovered by real-world entrepreneurs operating in specific institutional contexts. The Sah-Stiglitz framework brushes aside any context in which innovation and the discovery of economic information affect economic performance. By viewing economic projects as items in a metaphorical urn, they treat economic information as if it were on the shelf already, such that the only question is how to give people sufficient incentives to get them to pull it off the shelf and use it. This is to ignore the fun-

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damental question raised by Mises and Hayek: how information gets onto the shelf in the first place.

Hayek's insight—supposedly the starting-point of Stiglitz's concern with information (see Stiglitz 1994, 6, 24–26)—is that the market process allows us to exploit, utilize, and discover knowledge that had hitherto been *unknown* to market participants. Entrepreneurs do not choose the optimal production project from an array of known projects; they must *discover* opportunities for profitable ventures. They must be alert to as-yet overlooked opportunities and exercise good judgment in pursuing them. As Don Lavoie puts it, "the key point of the calculation argument is that the required knowledge of objective production possibilities would be unavailable without the competitive market process" (1985, 102).

The Sah-Stiglitz framework, by ignoring both the necessary ignorance of economic actors and the corresponding problem of knowledge discovery, directs attention from the questions real-world comparative-systems analysis must ask. The problem is not the establishment of the optimal conditions of competitive equilibrium, but rather the detection of errors—deviations, as it were, from equilibrium. To find such an error is to produce economic information that is useful in a world that does *not* approximate equilibrium; to use this information in order to make a profit is to move that world a little closer to the normative ideal. A comparison of capitalism and socialism that ignores their systemic ability (or inability) to engage in such error detection and correction is but another exercise in the use of equilibrium to indict reality while ignoring its positive dimension.

Similar difficulties afflict the work of Pranab Bardhan and John Roemer (1992), who argue that the revolutions of 1989 have unjustly discredited the socialist model. The system that failed in 1989, they point out, was characterized by public ownership of the means of production; noncompetitive, undemocratic politics; and central command over resource allocation. Bardhan and Roemer offer instead a model of socialism that jettisons central commands and noncompetitive and undemocratic politics, but public ownership remains intact. They interpret public ownership broadly to mean that the political process is in charge of distributing the profits of firms in order to achieve an egalitarian distribution of the economy's surplus. They claim that while a competitive market economy is necessary to achieve the efficient allocation of re-

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sources, private ownership is not a prerequisite for competitive markets.

In Bardhan and Roemer's view, unbridled capitalism generates negative externalities, not the least of which are political. The high degree of ownership concentration under capitalism perversely affects the political process through the influence of the wealthy, they allege. Thus, the efficiency gains of capitalism are offset by the subversion of democracy. Separating economics from politics, and vice versa, is essential to the establishment of a socially harmonious and just system.

The traditional problem with public ownership was the inability to separate political from economic criteria in resource-allocation decisions. Bardhan and Roemer try to avoid this problem by giving firms, not government, the power to allocate resources. But in order to prevent the unequal distribution of wealth, Bardhan and Roemer postulate a model of competition between firms in which property nonetheless remains collectively owned. The real issue, they argue, is competitiveness, not property ownership. The market must be constrained by egalitarian ownership: democracy in distribution, but competition in provision. Concretely, this means the distribution of equal entitlements to firms' profits in the form of shares that can be traded openly, but not cashed in. Shares can only be traded for other shares, not for money. Such a market, according to Bardhan and Roemer, would provide the necessary signals that a capitalist market provides, yet would prevent the concentration of capital.

To Bardhan and Roemer, the key question their model must answer is how to motivate the managers of public firms to act efficiently. They contend that modern research in industrial organization has demonstrated that the owner-entrepreneur model is no longer applicable to capitalist economies. The modern corporation can, however, be disciplined through the capital market and the managerial labor market, so Bardhan and Roemer proceed to replicate them through incentives schemes that tie a manager's reputation and salary to performance and to the distribution of unsaleable shares in their firms. Monitoring has been achieved on the economic front, and political control over the distribution of wealth has been maintained.

The perspective undergirding this model is the Stiglitzian program for recasting economic theory along "informational" lines. If

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one desires a society of change and mobility, then one should choose capitalism. But if stability and security are desired, then one should opt for socialism. Once incomplete and imperfect information are introduced, Chicago-school defenders of the market system cannot sustain descriptive claims of the Pareto efficiency of the real world. Thus, Stiglitz's use of rational-expectations equilibrium assumptions to achieve a more realistic understanding of capitalism than is usual among rational-expectations theorists leads, paradoxically, to the conclusion that capitalism deviates from the model in a way that justifies state action—socialism—as a remedy.[28]

One might well prefer even more realism, however—if one is willing to return to the days when accuracy was more important than mathematical virtuosity. While Stiglitz, Grossman, and Sah admirably introduce realistic elements into the equilibrium framework, that framework remains primary, preventing them from addressing the central issues of the socialist calculation debate. Human fallibility is introduced, but our capacity to adapt to changing conditions and to learn from false starts and ill-fated projects is not. Human imperfection is introduced into the analysis, but only to be condemned by contrast with the equilibrium ideal. Still missing from the analysis is an examination of how imperfect human beings attempt to cope in a real world of ignorance and uncertainty. As a result, we get the bifurcation of the world into a private sector that obeys rational expectations postulates while being unable to do anything to cope with the slightest departure from general equilibrium, and a public sector that, being the creation of the normative equilibrium theorists' imagination, is able to rectify the resulting problems "as if by an invisible hand." As in the earlier Neo-Keynesian synthesis of Paul Samuelson, the gap between norm and reality is closed by the omniscient state.

In Mises and Hayek's analysis, on the other hand, the complex web of institutions and habits that come into existense because of disequilibrium are the object of study. According to Mises and Hayek, legally secured property rights aid social learning in an imperfect real world by encouraging investment, motivating responsible decision making, allowing economic experimentation aimed at error correction, and providing the basis for economic calculation by expanding the context within which price and profit/loss signals can reasonably guide resource use. Formal models of competitive equilibrium, such as Lange's model of socialism, were not able to

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deal with such institutional questions; formal models modified to be superficially realistic, such as Stiglitz's new economics, are equally inadequate.[29]

In the Austrian argument the concrete context within which decisions are made conveys vital information. It is not just that information is costly to obtain, but that it is *different information* if it is stimulated by a context of rivalrous, private-property exchange. The knowledge actors rely on to make decisions is not universal and abstract, as it must be if it is to be replicated through either bureaucratic planning or political deliberation.

Moreover, in Bardhan and Roemer's model there is no realism, even of a superficial sort, concerning the workings of democracy. In the real world of mass democracies, principal/agent problems (cf. the "state theory" discussed in Evans et al. 1985) are just as real as those facing modern corporations, not to mention problems of preference falsification (Kuran 1995) and pervasive ignorance (e.g., Converse 1964; see Friedman 1996). Bardhan and Roemer equate political failure with the inequality of influence brought about by the power of money. (This equation is more assumed than proved.) Absent inequalities of wealth, they imagine that effective interest groups could not be formed, so the democratic process would enact the "will of the people." This leaves unexamined the question of the quality of democratic decision making even in the absence of interest groups, and it ignores the possibility that such factors as ideology, personal influence, identity politics, xenophobia, and differential ignorance (e.g., Neuman 1986; Zaller 1992) can be the source of unequal power as easily as money can.

VI. FROM POLITICAL TO ECONOMIC UTOPIANISM AND BACK AGAIN

Samuelson's synthesis created a rather strange mix of general equilibrium microeconomics with Keynesian macroeconomics. As Robert Lucas repeatedly pointed out in the early 1970s, graduate students were taught one thing during their Monday/Wednesday microeconomic theory courses, and another thing on Tuesdays and Thursdays in their macroeconomic theory courses. The link between microeconomics and macroeconomics was supposed to be found in the labor market. But if the labor market was in competi-

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tive equilibrium, this implied that the full-employment output level had been achieved, i.e., that there was no macroeconomic problem.

The circle was squared in Samuelson's Neo-Keynesian model by means of "wage stickiness" and the "money illusion." Unemployment, according to classical economists, was due to wage rigidity caused by labor union or government restrictions on wage adjustments. When there were no such rigidities, then wage cuts could serve to clear the labor market, and widespread, persistent unemployment could not occur. Keynesian economics, however, raised the possibility that unemployment could emerge endogenously in free markets because, first, discoordination between savings and investments in the capital market could produce an effective demand failure that would reinforce pessimistic expectations (see Keynes 1936, 245-71); and, second, because of workers' psychological resistance to nominal pay cuts, and their inability to distinguish nominal from real wages. The second of these problems has, like neoclassical socialism, been taken up by both descriptive and normative equilibrium theorists; indeed, the attack on this aspect of Keynesianism was central in the rise of the Chicago school—and, in turn, to its current displacement by the New Keynesianism.

In the Keynesian system as modeled by Samuelson, workers care about their relative nominal wage rather than their real wage. In bad times, then, workers will resist downward adjustments in relative nominal wages that might bring the labor market into equilibrium. This "stickiness" in wage adjustment makes possible the emergence of an unemployment equilibrium.[30] Only the tools of monetary and fiscal policy can shift the economy away from such a condition and toward full employment. Workers will be less aggressive in resisting the gradual and indirect downward adjustment of their real wages through inflation than they will in resisting direct downward adjustments of their nominal wages by their employers. Public-policy prescriptions guided by Samuelson's Neo-Keynesian synthesis, then, were predicated on the ability of the government to intervene so as to avoid the excesses of boom and bust and promote economic growth. The interventionist consensus came to be embodied in the idea that there existed a stable tradeoff between inflation and unemployment, and that it was the job of policy makers to negotiate this tradeoff.

The major difficulty with this model was that it relied on an assumption of worker irrationality that was every bit as implausible as

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the hyperrationalistic assumptions with which the Chicago school would soon replace it.

Samuelson's assumption that workers were systematically and repeatedly fooled by the money illusion was less a real synthesis of equilibrium modeling with Keynesian economics than an ad hoc, a priori amendment to the neoclassical microeconomic model of rationally self-interested behavior. As such, it was vulnerable from two directions: either from an Institutionalist attempt to preserve its ad hoc, "empirical" elements at the expense of neoclassical theory (Post Keynesianism; see Davidson 1989 and Prychitko 1993), or from a hyperformalist attempt to purify the synthesis by purging it of its Keynesian contaminants. The second route, needless to say, is the one that had the most appeal to a discipline now wedded to formal technique. This explains the astonishing success the Chicago school's "New Classical" economics would have in the 1970s in altering the policy agenda of a discipline that had been resolutely interventionist since the Great Depression.

The first shot in the Chicago counterrevolution was Milton Friedman's analysis of adaptive expectations. Next, the Neo-Keynesian synthesis was thoroughly discredited by the development of rational expectations theory.[31] Samuelson's reconciliation of the microeconomic ideal type with involuntary unemployment was repudiated, along with Keynesian prescriptions, in favor of the view that there could be no involuntary unemployment, hence that government action was unnecessary. The result was a doctrinaire derivation of the laissez-faire conclusions that had been overturned by the formalist revolution; economics was now cleansed of Keynesian impurities that had been introduced in the interest of realism. Equilibrium theory was now used not to indict the market economy, but to insist that it was perpetually in a state of rest. Pressed by the Chicago school for a coherent—formalistic—theory of how reality deviated from equilibrium theory, the Neo-Keynesian synthesis imploded.

Since formalist economics could not model the real-world processes of capitalist adjustment to disequilibrium, economists now had to choose between an irrational world of disequilibrium (original Keynesianism), a rational but unrealistic world of equilibrium (New Classical economics), and an untenable mixture of the two (Neo-Keynesianism). Neo-Keynesian economists, committed to formalism, had tried to fit Keynes's speculations about the failure of

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capitalist economies to maintain full employment into the program of general equilibrium theory. By the 1950s, their model had come to represent the intellectual standard of argument to which all economists who wanted to receive a serious professional hearing had to adhere. But Keynes's economics raised questions that were outside the scope of the model.[32]

The Chicago school resolved the tension between Neo-Keynesian theory and reality by insisting that reality must approximate (equilibrium) theory. But since the Chicago school was as committed to formalist methods as the Neo-Keynesians were, it could provide no more of a theoretical explanation of how real-world market economies could approximate full-employment equilibrium than Samuelson could plausibly explain how an unemployment equilibrium came into being. Perfect markets were a presumption, not a conclusion of New Classical economics, just as rigid unemployment was a presumption of Neo-Keynesianism.

The techniques of rational expectations and the development of New Classical economics came to dominate economic thinking in the 1970s and 1980s.[33] The assumption of perfect knowledge allowed the New Classicists to interpret all actual ignorance as optimal. Involuntary unemployment could not exist in this model because once search costs were included, the labor market was forever in equilibrium. Disequilibrium was considered incompatible with economic theory.[34] If someone was unemployed, it must be because she preferred to continue her search for a new job rather than accept work at the prevailing wage.

New Classical economists also sought to place the theory of the business cycle on firm equilibrium foundations.[35] Robert Lucas's theory of the business cycle presumed that noise in price signals prevented economic actors from distinguishing between changes in relative prices caused by market conditions and changes in the general price level caused by inflation. Increases in the money supply that translated into a change in the general price level should have no effect on the level of output, but if a change in the general price level were misinterpreted by economic actors as a change in relative prices, then the level of output could be distorted by the confusion. In this, the simplest version of Lucas's story, distortions must be caused by *unanticipated* changes in the money supply. The Chicago school's later "real"—as opposed to monetary—business cycle theory emphasized exogenous factors such as technological change

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and random shocks to explain fluctuations in the aggregate level of output.

The New Classical economics demanded too much. Economic agents were modeled to continually and optimally update their knowledge about the state of the world. In addition, economic agents were assumed to share the monetarist understanding of the effect of monetary policy on the price level. These assumptions gave economic actors the ability to checkmate policy makers. Systematic, rational government intervention was therefore useless. Only unanticipated government policy could affect the aggregate level of output. Despite the flawless precision of this model, it produced a view of the world that was obviously contrary to reality. It is not controversial to insist that real involuntary unemployment, for example, existed during the 1930s. Yet the Keynesian explanation of how this phenomenon occurred assumed economic agents without adaptive qualities.[36] Constrained by the methodological demands of formalism, economists had no way to explain imperfect adaptation to changing economic conditions, so they opted to explain away such imperfections rather than accept them, *à la* Neo-Keynesianism, as brute facts.

The perfect-market assumption and the extreme policy implications of New Classical economics led, in reaction, to the development of the New Keynesian economics and a resurrection of the analytical importance of involuntary unemployment (see Gordon 1990 and Summers 1990). The New Keynesians sought to provide rational-choice microeconomic foundations for wage and price stickiness.[37] The first New Keynesian models emphasized nominal rigidities in the price system. In contrast to the New Classical model, which assumed that prices were perfectly flexible, the New Keynesians emphasized that prices are often quite inflexible for a variety of reasons. Real-world labor markets, New Keynesians contended, are often characterized by inflexibility due to the prevalence of long-term contracts, so even if agents have rational expectations, nominal rigidities prevent perfect adjustment and create the need for Keynesian interventionist policies.

However, the early New Keynesian models were criticized by New Classical theorists for lacking a rational-choice foundation for the long-term labor contracts to which they attributed market rigidity. Why would profit-maximizing firms repeatedly lock themselves into long-term contracts that would prove suboptimal at

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some later date? The next generation of New Keynesian models emphasized real rigidities in market adjustment, while retaining the behavioral assumption of rational expectations (or near rationality) throughout the structure of the model. In a world of imperfect information and imperfect market structure, New Keynesian economists such as Stiglitz were able to demonstrate that a non-market-clearing equilibrium could emerge. Thus, real rigidities were capable of generating involuntary unemployment in long-run equilibrium. Furthermore, New Keynesian models were immune from the criticisms leveled against Keynes and the Neo-Keynesians for assuming persistent worker irrationality and misperception of the price level. The New Keynesian models are populated by maximizing agents who suffer no informational disequilibrium, yet who experience involuntary unemployment. This was an intuitively pleasing development because, as Robert Gordon points out, it is evident that unemployed workers and firms are unhappy about their condition. "Workers and firms do not act as if they were making a voluntary choice to cut production and hours worked."[39] Paul Krugman writes that "the new Keynesian idea serves a critically important purpose. During the 1970s conservative macroeconomics had Keynesianism on the run with its assertion that it was a logically flawed theory—that it *could not* be right. The new Keynesian theory showed, on the contrary, that the idea that recessions represent a market failure that can be corrected by government action can indeed be right. This is useful, because in reality Keynesianism is basically right, so it's nice to have a theory that lets us admit it" (Krugman 1994, 215).

New Keynesianism is able to achieve this result by means of the efficiency wage theorem. If workers' productivity depends on their wages, it may be rational for employers to offer a wage rate that exceeds the market-clearing level.[40] They may refuse to lower wages to the market-clearing level, fearful that the productivity of their existing workforce will fall. A higher-than-market-clearing wage may therefore be rational, since workers, realizing that the wage is significantly higher than wages they could obtain by working elsewhere, will work harder, shirk less, quit less often, and be loyal and diligent.[41] The downside of the higher-than-equilibrium wage, however, is that both unemployed workers and firms face difficulties in bidding down the price of labor.[42] Too-high wages, and thus involuntary unemployment, are structurally embedded in capitalism.

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This model is, however, as formalistic as its Neo-Keynesian and New Classical predecessors. The New Keynesians raise many interesting questions about market frictions, but since the model of general competitive equilibrium remains the benchmark, the efficiency wage simply replaces the money illusion as an ad hoc, empirically ungrounded dogma purporting to explain why, in an otherwise perfect world that approximates the equilibrium model, inconveniences such as unemployment seem to occur. To be sure, New Keynesianism is an improvement upon the New Classical assumption of the instantanous adjustment of all markets, including the one for labor; the New Keynesians at least take notice of the existence of involuntary unemployment. But their explanation of this phenomenon is inconsistent with even the most cursory examination of the way real-world firms tend to set wages. Everyday experience suggests that high wages are often *caused by*, rather than being the cause of, talents that are in great demand; and that when demand for a worker's talents slackens, her wages are cut. Such observations reopen the door to explanations of involuntary unemployment in which some exogenous factor renders labor unable to accept wage cuts in order to avoid unemployment, since it would seem that if there is systemic unemployment, something must be disrupting the market's profit-and-loss error-correction mechanism. At this point economics will have parted decisively with New Keynesianism, since the latter view *presupposes* that the market contains endogenous sources of mass unemployment.[43]

It is entirely possible, of course, that in some firms, industries, or even entire economies, the New Keynesian story will turn out to hold good. But surely the burden is on the spinners of this tale to demonstrate how often it is anything more than speculation; and they have no more discharged this obligation than their New Classical opponents have demonstrated the existence of perfect markets. Instead, the New Keynesians appear to be satisfied with having put rational-choice foundations under Keynes's conviction that market adjustments alone *cannot* solve unemployment. Like rational-expectations theorists who developed elaborate "proofs" of how the (Neo-)Keynesian picture *could not* be true, the New Keynesians start with the assumption that it (or something very much like it) *must* be true, and then try to explain how this "reality," as Krugman puts it, might have come to be. In the end, then, the New Keynesians are as ideological as the Chicago school. In the hands of both,

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economics is reduced to a game in which preconceived notions about the goodness or badness of markets are decked out in spectacular theory. In neither case do economists fulfil the fundamental scientific responsibility of testing the veracity of their explanations.

To make such a serious charge against the two dominant schools of contemporary economics, however, is to do little more than notice the logical implication of their use of the equilibrium model as either a representation of reality or an indictment of it. And this brings us back to the marginalization of the old style of neoclassical economics that took place shortly after Hayek's speech of 1933. It was, after all, an ideological impulse—the desire of left-wing economists to justify Keynesian interventionism and socialism—that led to the initial triumph of formalism. These economists needed no persuading that the market had little capacity for self-correction and adjustment to disequilibrium; thus, they treated the state as a *deus ex machina* that could close the gap between theory and reality. The Chicago school's reaction against this view was equally ideological, for all its scientism; but here the *deus ex machina* was the market itself. Even while Hayek was seen as ideological because of his inability to make his case in the language of "scientific" formalism, the introduction of this language actually had the effect of licensing any ideological predisposition that *could* be translated into its terminology.

Both the Chicago school's utopian view of reality and its opponents' dystopian view were given life by the assumption that equilibrium was necessarily intended to be a description of the market. The Chicago school simply affirmed this intention by praising the "magic of the market." The Keynesians, Neo-Keynesians, and New Keynesians also affirmed the intention, but they denied that the resulting description was accurate. They were led, in consequence, to view the model as an ideal that is attainable only by government action; they replaced the magic of the market with the magic of the state. Neither the Keynesians nor the Chicagoans explain how imperfection can be *institutionally* remedied, rather than circumvented by either market or political actors with heroic capacities.

What both schools overlooked was the fact that equilibrium is a static construction that could not possibly represent a dynamic world of time, ignorance, and uncertainty; but that the divergence between ideal and reality can highlight the ways reality may have institutionalized error-correcting properties that can, in fact, be seen

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as propelling the world in a direction reminiscent of general equilibrium. But like any ideal type, equilibrium is a postulate *that is not necessarily effected in the real world.*[44] The main task of any science is to investigate the degree of correspondence between various ideal types and empirical reality; but this means that science is primarily a matter of experimentation or, in social science, historical research—not model-building but model-testing (i.e., testing of the applicability of intelligible models to given situations). Still, the "falsification" of an ideal type in a given instance does not require that it be discarded as useless. It may aid the scientist in constructing ever more realistic models of the circumstances of that particular time and place. This procedure once allowed economics to be something quite different from an exercise in the provision of rationales for predetermined conclusions.

VII. WHAT WENT WRONG

I do not claim that economists who followed the ideal-type procedure, such as Hayek, were immune from ideology themselves. But in principle, treating models as ideal types allows one, or one's colleagues, to root out one's ideological prejudices by subjecting one's models to the empirical test of applicability as well as the philosophical test of intelligibility.

This view of ideal-typical science is itself, of course, an ideal type; it will apply more to some scientists or disciplines in some eras, and less to others. Unfortunately, since 1933 the trend of Western economic thinking has been to turn this ideal type—and this ideal—into nothing but a pious hope. Despite economists' official adherence to Milton Friedman's methodological positivism, the testing of theories against reality has become less and less central to their activity; instead, the generation of formal models has become an end in itself.[45] This was virtually inevitable, since the tenets of formalism require that economic argument must be placed in a certain language if it is to be considered scientifically legitimate.[46]

As a result, none of the main centers of economic education convey a *theoretical* understanding of *real-world* market institutions. That is not viewed as their educational purpose. D. N. McCloskey (1991, 12) has pointed out that "economics in American universities has become a mathematical game. The science has been drained out of economics, replaced by a Nintendo game of assumptions . . .

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with as much practical payoff as chess or lotto." Instead of producing economists who seek to understand the working properties of economic forces in real historical time, "the graduate schools in economics have been producing scientific illiterates." These are sharp criticisms, but they are more or less on target. Arjo Klamer and David Colander's study, *The Making of an Economist* (1990), details how the formalist revolution substituted mathematical skill for sensitivity to historical and institutional details, and how students have responded predictably to the internal reward system set up by formalist economics.

The devolution of thought that Hayek perceived at the time he wrote "The Trend of Economic Thinking" provides a useful point of comparison with the present situation. Just as Hayek saw the real danger as residing in the second generation of anti-theoretical economists, the first generation of formalists, having been taught by older economists, still possessed a sense of historical and institutional realism that was absent in the next and subsequent generations. Equilibrium models still had to meet some standard of realism, even if these standards no longer had official methodological legitimacy. Thereafter, however, it was the model, and not the world, that became the dominant source of intellectual excitement. Technique has trumped substance ever since.

As a result of this natural progression of the formalist revolution, a new form of theoretical relativism has emerged. Hayek saw Historicism as providing a relativistic challenge to the analytical claims of classical and neoclassical economics, especially when applied to public policy. Arguments for laissez faire were rejected by Historicists on the grounds that they were based either on faulty assumptions about human nature, or on analysis that may have been true for one period of history, but was irrelevant in another period. But this apparently fact-based, scientific approach did not actually provide empirical evidence that, say, the "laws" of supply and demand were "repealed" in certain historical epochs. To do this, Historicism would have had to explain what motivated observed economic relationships in the absence of such "laws." But, for the most part, no such alternative explanations were forthcoming. Instead, Historicists typically pointed to some phenomenon that seemed on the surface to contradict economic "laws," and then reached the sweeping conclusion that in the face of such phenomena, one should abandon theorizing about them in favor of data collection and policy ad-hocery. This naive empiri-

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cism had the effect of substituting confused, *sub rosa* theorizing for the careful, refutable theorizing embodied in classical economics and canonized in Weber's method of ideal types. In the guise of repudiating the classical economic assumption that instrumentally rational behavior is an ideal type that is *universally* instantiated in the real world, Historicism proposed an equally a priori, unscientific theoretical scheme—a scheme of historically determined motivational pluralism unfounded on any rigorous investigation of behavioral evidence—but one that could not even be debated intelligently, since the theoretical claims about a given era were implicit and incoherent.

The formalist revolution generated a similar disregard for empirically meaningful and rigorous theorizing. Ideal-type theorizing had been designed to establish whether real-world *processes* might explain the movement of disequilibrium phenomena toward an ever-elusive hypothetical equilibrium. But to render the equilibrium model in mathematical terms, formalists had to view it as a *static* condition against which disequilibria could only be compared timelessly—or banished as an illusion.

Different formal models generate different conclusions, and since each model is, in principle, equally unable to explain real-world disequilibria, there is no way to choose between them in any absolute sense. Economic arguments against interventionism based on New Classical assumptions could just as easily be false as arguments for intervention based on New Keynesian assumptions could be true. All we have is a succession of logically consistent and very elegant models that say little or nothing about the world—except that anything is possible.

What is true of contemporary macroeconomics is also true for microeconomics. Consider the situation in industrial organization. As Franklin Fisher (1991) pointed out in a review essay on the *Handbook of Industrial Organization,* the main organizing principle of modern industrial organization is that there are no organizing principles. Modern theory simply demonstrates that anything can happen, given different assumptions. All of the models are admittedly unrealistic and do not illuminate real situations in the economy. This is viewed as a pragmatic weakness, but not a "theoretical" weakness, since theory has been divorced from reality. The unrealistic simplicity of the models is designed to allow theorists to do complicated mathematics, not to allow testing against reality. Con-

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versely, the empirical analysis that does occur is rarely informed by theory. And any policy preference can be backed up in some vague way by one model or another.

Ironically, the interventionism this allows is a product of the methodology of the arch-laissez faire Chicago school. Samuelson was responsible for transforming economic theory into a branch of applied mathematics, but Milton Friedman must share some of the responsibility for transforming the psychology of economists by means of his seminal 1953 *Essays on Positive Economics*—one of the staples of graduate economic education over the last four decades, along with Samuelson's bible of technical economics.

Friedman argued that an assumption's realism mattered little as long as it *could* produce positive predictions. Part of what went wrong with economics, it might be argued, is that this testing is the exception rather than the rule (see, e.g., Rosenberg 1994). But the problem goes deeper. Even in the wake of formalism, theorists had been constrained by an historical and institutional sensitivity that prevented them from introducing blatantly false assumptions.[47] Friedman himself, for example, had attacked Abba Lerner's *The Economics of Control* (1944) for failing to address many of the institutional questions that would arise from using the price system in the absence of private-property ownership. *The Economics of Control* was economics in a vacuum, according to Friedman, and was not "combined with a realistic appraisal of the administrative problems of economic institutions or of their social and political implications" (1953, 319). But just such an appraisal is undermined by Friedman's methodology. All Lerner had done (like Lange before him), after all, was replicate for socialism the unrealistic model assumed to be legitimate for capitalism—the model of perfectly competitive general equilibrium—that Friedman had placed at the foundation of the Chicago school's understanding of economic *reality*. Change a few assumptions here and there, and it follows that general equilibrium socialism can achieve the same efficiency properties as general equilibrium capitalism. Since real-world capitalism deviates considerably from competitive equilibrium (and is more likely to correspond to monopolistic rather than competitive equilibrium), real-world socialism built on the Lange-Lerner model would outperform capitalism. Yet in his role as comparative systems economist rather than methodologist, Friedman implies that only a seri-

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ous case of confusing mental constructs with empirical reality could result in this judgment.

By the same token, Friedman's famous advocacy of economic laissez faire, unlike that of such later Chicagoans as Gary Becker, is in most cases unconnected to the general equilibrium model. Rather, Friedman's policy outlook is deeply shaped by Hayek's analysis of the informational difficulties of government planning and Hayek's understanding of spontaneous order, combined with James Buchanan's work in public choice theory and constitutional political economy (see, e.g., Milton Friedman 1979). Later economists, however, took Friedman's methodology more seriously than he himself seems to have done. His pragmatic concerns were swept away in favor of elegant formal modelling. The economic world is no longer an object of study; the formal model of an abstract economy is what is of concern to economic scientists.[48] Thus, Gary Becker (1976, 5) defines the economic approach as the relentless and unflinching use of the postulates of maximizing behavior, market equilibrium, and stable preferences. His efficiency claims about the market are predicated on the assumption that these postulates are descriptively accurate, even though they are propositions in comparative statics while the real world is evidently dynamic.

Faced with the kind of criticisms of this view that have been raised by Arrow, Stiglitz, and other market-failure theorists, Chicago economists typically respond by insisting that the real world is in equilibrium *when all the appropriate costs are included in the analysis*. In other words, the market-failure theorists have made an illegitimate comparison between an ideal state and the imperfect world. Demsetz's attack on the "nirvana fallacy" is an example of this style of Chicago response to suggested market failures. Demsetz argues that Arrow's market failure theory results from an illegitimate chain of reasoning that begins with a deduced discrepancy between the ideal situation and the real situation, which is then transformed into a demand for perfection by the use of an unexamined alternative arrangement. This call for perfection by incantation is guilty of the fallacy of the free lunch, i.e., the belief that the alternative arrangement could be established costlessly (Demsetz 1969).

This response, while making an important analytical point about comparative institutional analysis, nevertheless contains a bias in favor of the status quo that Demsetz fails to justify. He implies that

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whatever exists must be efficient; otherwise, change for the better would have already occured. But if the economy were as efficient as Demsetz assumes, many of the phenomena Chicago economists study—including money, firms, and law—would not exist.[49] Such institutions enable economic processes in the real world to achieve whatever degree of self-correction and economic coordination the formal model of competitive equilibrium was supposed to capture in the first place; yet these institutions come into being only to the extent that equilibrium is not a description of reality, but an ideal type that does *not* describe reality.

The New Classical economics that emerged in the 1970s and 1980s displayed the same complacency about the status quo, dismissing involuntary unemployment as theoretically incoherent and empirically void. For involuntary unemployment to be a myth, the New Classical economists posited economic actors who adjusted their behavior so quickly (for all practical purposes, instantly) that equilibrium would be achieved at all points. Compared to this, the New Keynesian efficiency-wage theorem appears the model of sober realism.[50]

New Keynesianism interventionism is nourished by leaks in the supposedly watertight equilibrium theory of the Chicago school. But the arguments for the new interventionism are simply variations on the bad habits that gave rise to the Chicago school. Imperfect market theory, like perfect market theory, is addressed to a model, not to the world the model is supposed to illuminate.

* * *

Alan Coddington has pointed out that "instead of asking how reason can be applied to the knowledge that men can or do have of their economic circumstances," modern economic theory "asks how reason can be applied to circumstances which are perfectly known." The troublesome problems of "what can be known, and how it can come to be known—problems of ignorance, uncertainty, risk, deception, delusion, perception, conjecture, adaptation and learning—are then tackled as a complication and refinement on the theory" (Coddington 1975, 151). Modern theorists' static conception of reason is in direct conflict with the passage of real time (O'Driscoll and Rizzo 1985, 52–70). The postulates of rational choice theory can only generate formal proofs if the future (with its novelty, uncertainty, and ignorance) is excluded. Modeling that

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excludes this component of reality not just for counterfactual purposes, but as part of realistic attempts to describe or condemn the market, are bound to be insufficient.[51]

This is not, as I have tried to demonstrate throughout this essay, simply a methodological complaint. It has a host of serious implications. The temporal structure of production, for example, with its employment of heterogeneous components to form the various combinations that make up the unique capital structure of a given economy, are excluded from modern analysis. As a result, the way market signals constantly reorganize capital combinations remains invisible to the modern economist. Nor is the impact of monetary price adjustments on the pattern of exchange and production fully incorporated into economic theory: either prices are assumed to represent the underlying information perfectly (competitive equilibrium), or they are assumed to reflect that information so imperfectly that they constitute market failure. In both instances, the informational content of the price system is misrepresented. As should be obvious, this has profound implications for understanding various economic systems and paths of economic development.

The precision of equilibrium modeling is gained at the expense of correspondence with the imprecise world the model was once supposed to help us understand. Paradoxically, the careful expression of imprecise concepts and processes in natural language supplies us with a more accurate picture of the economic world than the most rigorous mathematical modelling. Careful thought requires coherence; relevant thought requires correspondence to reality. Good economics requires both coherence and correspondence.

The often-stated argument that mathematical modeling eliminates ambiguity in thought by forcing theorists to state assumptions explicitly is based on a conflation of the concepts of *syntactic* and *semantic* clarity. Mathematical reasoning ensures that modeling is disciplined by syntactic clarity, but semantic ambiguity is the result (see Coddington 1975, 159). The abandonment of mathematical reasoning using equilibrium models would herald a return to semantically rigorous standards of argument about the economic world "out there."

The twentieth century's oscillation between perfect market theory and market failure theory, both of which take as the terms of debate the formal model of general competitive equilibrium, will inevitably be won by theorists of market failure. It is obvious that

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the economic world is not perfectly competitive (or even near that state of affairs). Hence the triumph of the interventionism Hayek forecast—not because economic theory has been rejected, but because it has been misconceived. While Stiglitz and other contemporary market-failure theorists intend to rebut Hayek's analysis of the benefits of the private-property, competitive-price system, in reality their response to Hayek constitutes a non sequitur.[52] Since Hayek's argument did not depend on the achievement of static equilibrium, the deviations of real markets from the model do not constitute rebuttals to him. Indeed, deviations from the model were Hayek's starting point.

To address Hayek's argument seriously, economists would have to drop the false precision of equilibrium models and engage in careful reasoning about imprecise phenomena, such as the passage of time, the limits of our knowledge, the uncertainty of the future, and the discovery of opportunities.[53] Perhaps Hayek's argument cannot be sustained when confronted in this manner, but this we will not know until seven decades' worth of disastrous formalization is abandoned and the realities of economic life are re-engaged.

NOTES

1. Of course, the Austrians were involved in major debates of this era among mainstream economists, notably the capital theory debate (with J. B. Clark) and the value and price theory debate (with Alfred Marshall). These were, however, viewed as intramural analytical, not programmatic, debates. Marginalists were thought to be analytically united, despite differences over subsidary assumptions or even broader issues of pre-analytical vision.
2. Henry Hazlitt's critique of the Keynesian system, presented in *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies* (1959), argues that many of the fallacies within Keynesianism are the consequence of misunderstanding orthodox doctrine. See also Hazlitt 1960.
3. See Skidelsky 1992 for an intellectual biography of Keynes during the time of the writing of *The General Theory*.
4. Samuelson's hold over economists can be explained on two levels. First, economists suffer from physics envy; Samuelson's mathematization of economics promised to complete the transformation of economics into social physics that was started by Leon Walras. Second, Samuelson was not only smart, but strategic. Shortly after his *Foundations* became the major textbook in graduate education, Samuelson's *Economics* became the leading un-

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dergraduate text. Samuelson influenced students on their way in and on their way out. Within a decade, Samuelson became synonymous with economics, and his hold over the style—if no longer the substance—of economic reasoning has not waned since.

5. See Samuelson 1947, 203–53, where he discusses welfare economics and the implications of the competitive model. Also see Samuelson 1961, 678–89 and 818–36, for his undergraduate textbook's treatment of the issues related to socialist planning.
6. One of the best examples of this reversal is to consider the interpretive difference between Samuelson and Hayek on the implications of the equilibrium pricing theories of Pareto (1909) and Barone (1908) for collectivist planning. Hayek included a translation of Barone's essay in his *Collectivist Economic Planning* (1935) precisely because he thought it was clear that Barone demonstrated the practical inability of the collectivist planning system to replicate what is achieved in the competitive market economy. Similarly, Pareto is explicit that the collectivist planner would confront an insurmountable task even in a simple economy, whereas the capitalist system solves the problem of economic calculation every day through the impersonal market process. Both Barone and Pareto, however, demonstrated that in order to achieve economic efficiency in production, collectivism would have to solve the same set of equations as competitive capitalism. In other words, there was a formal similarity in the economic problem in both capitalism and socialism. The recognition of this formal similarity was preliminary to the analysis of the problems that collectivist planning would confront, not their solution. Yet since Samuelson contended that Mises's critique of socialism was refuted in advance by the work of Barone and Pareto, he contended that the collectivist planning system could simply replicate the trial-and-error process explicated by Barone and Pareto. The fact that both Barone and Pareto explicitly denied that such a replication was possible in practice is brushed aside by Samuelson.
7. Besides Samuelson, the most important figures in this transformation of economics were Kenneth Arrow, Gerald Debreu, and Frank Hahn. It is no coincidence that each of these individuals made major contributions to market failure theory in addition to their development of the model of general competitive equilibrium.
8. In perhaps the best intellectual biography of Coase to date, Steven Medema (1994) argues that Coase was concerned with examining the consequences of alternative legal arrangements on economic performance rather than in using economic techniques to examine the law. This difference in emphasis explains Coase's lack of interest in Posnerian law and economics, a movement more concerned with the use of economic techniques to examine the efficiency of various legal arrangements. Coase not only suggested an alternative comparative institutional program of research, but thoroughly questioned the logical coherence of mainstream

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neoclassical economics. Part of the equilibrium exercise that Coase engaged in was to show that pursuing the logic of maximizing within an environment of zero transaction costs led to conclusions different from those suggested by Pigouvian welfare economics. If transaction costs were zero, then economic actors would negotiate away the conflict; if transaction costs (including informational costs) were positive, then how would authorities know what the right level of tax or subsidy should be to correct the situation? Coase's research program entailed both a critique of prevailing practice and a positive alternative program that is now emerging in the New Institutional Economics, of which Coase is still the leading representative.

9. Krugman 1995 admits that the development theory of Albert O. Hirschman and Gunnar Myrdal was essentially correct in its emphasis on strategic complementarity in investment, and in using coordination failures to explain why some countries are rich while others remain poor. But these ideas were ignored by economists in the 1950s and 1960s because they were not properly modeled—which Krugman defends, because only a properly modeled idea deserves serious attention by the profession. Avinash Dixit (1996) makes a simliar argument with respect to the economic theory of politics. It is this attitude among the second and third generation of economists after Samuelson that has come to dominate mainstream economics.
10. I have addressed this evolution in economic thought in Boettke 1996a. Cf. Heilbroner and Milberg 1995.
11. Nothing I have said in this paragraph is original to me: See Hirschman 1986 and Sen 1987. Hirschman has proposed that we complicate economic discourse by recognizing the incredible complexity of human nature, while Sen suggests that we recapture moral philosophy in economic discourse.
12. Various scholars often blend the different uses. Frank Knight, for example, used equilibrium as an ideal type in his classic *Risk, Uncertainty and Profit* (1921), but in *The Ethics of Competition* (1935) he used it as a critical normative standard. Alfred Marshall is remembered as the pioneer of partial equilibrium analysis (which assumes an overall equilibrium in the economy, but focuses on a particular market), often assumed to be the hallmark of the Chicago-school approach, but we can also read Marshall as an ideal-type theorist when he states that equilibrium analysis is preliminary to an "advanced study" that would be more evolutionary in nature (Marshall 1920, 269). Nevertheless, even in these cases one can easily distinguish between the various deployments of the equilibrium construct.
13. See Jeffrey Friedman 1995 for this version of Weber's methodology of ideal types. Cf. Weber [1956] 1978, 9–12. Machlup 1978, 207–301 discusses the ideal-type methodology as applied to economics in general. Cf. Weber [1956] 1978, 10, on "the 'imaginary experiment' which consists in thinking away certain elements of a chain of motivation and working out the course of action which would then probably ensue, thus arriving at a

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causal judgment." Mises (1949, 236–37) describes this approach as "the method of imaginary construction." Cf. Hayek 1940, 14–28.

14. Those inclined toward the descriptive use of equilibrium basically deny that these seemingly complex problems exist in the world. Philosophically, the argument relates back to the ancient assertion that change is an illusion. On the other hand, those who use equilibrium as an indictment of reality view the existence of a problem as, *by definition*, evidence that the ideal solution of competitive equilibrium is obtainable somehow. If the market does not attain perfection, then the state *must* be capable of it.
15. The relevant papers by Hayek are collected in Hayek [1948] 1980.
16. In "Economics and Knowledge," Hayek argues that the pure logic of choice is a necessary, though not sufficient, component of an explanation of systematic economic coordination. An understanding of economic coordination requires an empirical understanding of *learning*. Hayek's research program for economics would have shifted it from the determination of optimal resource use under given conditions to the exploration of the impact of alternative institutional environments on learning.
17. Picking up a theme first raised by Oskar Morgenstern, Hayek emphasized that perfect foresight was a defining characteristic of equilibrium but not a precondition that must be present for equilibrium to be obtained. Logically, in fact, what Morgenstern had demonstrated was that if economic agents possessed perfect foresight, then a determinate equilibrium solution would evade them. As Joan Robinson also emphasized, the only way to acheive an equilibrium would be to already *be* in equilibrium—no process toward equilibrium could be articulated on the basis of a theory of perfect foresight. The implication for Hayek of this theoretical conundrum was that economists should focus attention not on the state of equilibrium, but on dynamic adjustment and learning through time. "A theory which starts out by assuming that adjustments have proceeded to the point where no further changes are required," Hayek stated, "is without relevance to our problems. What we need is a theory which helps us to explain the interrelations between the *actions* of different members of the community during the period (which is the only period of practical importance) *before* the material structure of productive equipment has been brought to a state which will make an unchanging, self-repeating process possible" (1940, 16–17).
18. Kirzner 1997 is an examination of how the theory of entrepreneurial learning fits into this research program and contrasts with standard price theory. Fisher 1983 is a discussion by a leading equilibrium theorist of the necessity of disequilibrium foundations for equilibrium economics. A theory of convergence to equilibrium, according to Fisher, has to be developed, not assumed.
19. On the theory of search, in contrast to the Austrian view of the market process, see High 1990, 28–36 and 83–124.
20. This line of literature explored information/communication and motiva-

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tional questions associated with the structure of incentives. The main conclusion was that decentralization was less important than incentives. But the version of decentralization explored in these models was far different from Hayek's hypothesis about the use of knowledge in society, even though Hayek was supposed to be the starting point of this literature.

21. Information economics led economists to investigate agency costs, informational asymmetries, strategic interaction, and organizational design. These are all important problems, but the models developed to explore them arguably fail to capture how real-world adjustment processes deal with them.
22. For overviews of this work in information-theoretic research in economics see Stiglitz 1994 and Grossman 1989. A textbook-style treatment of information-theoretic economics in general can be found in Campbell 1995. An Austrian critique of the Stiglitz-Grossman program can be found in Thomsen 1992. For critical discussion of Stiglitz 1994 see Boettke 1996b and Prychitko 1996.
23. The strong assumption of rational expectations had become by the mid-1970s common in all models.
24. Buchanan [1964] 1979, 17–37, also forcefully argues that economists should concentrate their efforts on exchange relationships and the various institutional arrangements that result from these relationships, rather than equilibrium states, placing Buchanan alongside Mises and Hayek and earlier thinkers such as Richard Whateley. Also see Kirzner 1973, 212–42.
25. There has been some debate over the relative importance of Mises's calculation argument and Hayek's knowledge problem. But they seem to me to be two sides of the same coin. Calculation without knowledge is oxymoronic, and knowledge without the ability to do economic calculation is unimportant. Private property and monetary calculation are the means by which the knowledge problem can be solved in complex economies. That is the argument Mises's and Hayek's critiques of socialism shared, despite their differences of emphasis. As Mises points out in *Liberalism*, the "decisive objection that economics raises against the possibility of a socialist society [is that] it must forgo the intellectual division of labor that consists in the cooperation of all entrepreneurs, landowners, and workers as producers and consumers in the formation of market prices" (Mises [1927] 1985, 75). See Boettke 1996c for further discussion.
26. The informational content of a multitude of market practices, not just monetary prices, is recognized by Hayek and others in the Austrian tradition, such as Fritz Machlup. Stiglitz's attempt to remedy the unrealistic nature of descriptive equilibrium by paying attention to information is doomed to failure because information is dynamic, yet formalism renders it inherently static.
27. See Boettke 1993, 135–38.
28. Stiglitz does demonstrate the sensitivity of general equilibrium results to initial assumptions. Even rational expectations models do not yield

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Chicago-type efficiency conclusions once slight changes in the initial assumptions are made as (half-hearted) concessions to realism.

29. Lange, for example, accused Mises of "institutionalism" for suggesting that the ability to engage in rational economic calculation was related to a specific institutional context, namely private property in the means of production. See Lange 1939, 62 n 6. Stiglitz 1994, 174–75, also doubts the importance of private property in influencing economic performance.
30. Equilibrium here is defined in its classical sense: a state of affairs where there are no endogenous forces that will change the existing state of affairs. Defining the equilibrium state was fundamental to the Keynesian project. As Franklin Fisher writes: "The central question which Keynes sought to answer in *The General Theory of Employment, Interest and Money* was that of whether (and how) an economy could get stuck at an underemployment equilibrium. To show this, it is not enough to show that such an equilibrium exists, we must also show that it has at least local stability properties so that an economy that gets close enough to such a point will not escape from it without an exogenous change in circumstances" (Fisher 1983, 9).
31. Friedman's theory of adaptive expectations was actually his last in a long line of criticisms of the Keynesian analytical and public policy system. His work on consumption theory had questioned the behavioral premise of the Keynesian theory of consumption, his work on the quantity theory of money challenged Keynesian monetary theory, and his work on rules versus discretion raised doubt about Keynesian fine-tuning.
32. Keynes's theory of the failure of modern capitalism relied on cultural and psychological factors as much as economic ones. The emergence of the much-vaunted "casino" character of the stock market was, according to Keynes, a result of a change in the culture (and the population pool) of trading. In the nineteenth century, more civilized and cultured traders guarded against wide swings due to animal spirits. In the twentieth century, however, old habits evaporated and with them breaks against the wild tides of optimism and pessimism. The interventionist policies Keynes advocated to correct for market breakdown were predicated on the assumption that those in government would be in a better position to assess the efficiency of capital investment (especially in the long term) than those trapped in the hustle and bustle of current market behavior.
33. For a collection of the main papers see Lucas and Sargent 1981. Also see Snowdon, Vane, and Wynarczyk 1994, 188–218; and Hoover 1994.
34. See, for example, Lucas's interview in Klamer 1984. This dismissal of disequilibrium theory aborted not only the development of traditional Keynesian analysis, but also the work of Clower and Leijonhufvud, Post Keynesian analysis of the sort done by Paul Davidson, as well as Austrian economics. Fisher has characterized Lucas's position "always-clearing markets." When one takes this position, equilibrium analysis does not need any justification. Movements of actual market prices are to be analyzed as a se-

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quence of temporary equilibria. Price offers are instantly adjusted to the short-run equilibrium point. See Fisher 1983, 5–6.

35. When Lucas first articulated an equilibrium theory of the business cycle he would often cite Hayek (a recent Nobel Laurate at the time) as a precursor of his approach. Hayek did, in fact, insist that Keynesians had committed an error by not developing an equilibrium theory of the business cycle. But what Hayek meant was that one cannot offer an explanation of unemployment unless one begins in a state of full employment and explains why the unemployment resulted in the first place. In the system articulated by Keynes and his early followers, full employment was denied at the start of analysis—one began with unemployment (idle resources). Hayek used the equilibrium state of full employment only as a preliminary to the real analysis, which was to explain how unemployment may emerge. Hayek's position, then, was in direct opposition to both Keynes and Lucas. Keynes assumes what needs to be explained, and Lucas treats equilibrium not only as the beginning, but also the end, of his analysis.
36. One of the problems with the Keynesian system was the lack of symmetry in the motives and behavior attributed to economic agents, as opposed to the economist-experts who would fine-tune the economy. Economic agents were assumed to be irrational and self-interested, whereas government policy-makers were presumed to be completely rational and public spirited. Like all ideal types, this one *might* be found to represent reality in a given time and place; but this needs to be proved, not assumed. Otherwise the theorist can simply predetermine policy conclusions by manipulating assumptions.
37. For a collection of the main papers in New Keynesian thought see Mankiw and Romer 1991. Also see Snowdon, Vane, and Wynarczyk 1994, 286–330; and Keenan 1994. One of the crucial differences between New Classical and New Keynesian models can be found in the assumption of *price taking* behavior within the New Classical models and *price making* monopolistic behavior within the New Keynesian models.
38. As Samuelson emerged as the central figure in the formalist revolution, Stiglitz is emerging as the central figure in contemporary economics. Not only does Stiglitz's work, like Samuelson's, dominate the graduate curriculum, but he has published an introductory-level textbook, *Economics* (1993), summarizing the extent of his vast contributions to economics for a new generation of students. Just as Samuelsonianism defined economics from the 1950s through the 1970s, Stiglitzian economics is likely to dominate economic thinking and education from now until well into the twenty-first century. Stiglitz's influence has also been more direct, as he has served as the chief economist in the President's Council of Economic Advisors and the World Bank. Many Stiglitz-inspired arguments have been deployed in policy debates over intervention in the health-care industry (adverse selection), banking (adverse selection and moral hazard), and antitrust (imperfect competition).

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The effect of Stigliz's influence is to make economics even more presumptively interventionist than Samuelson preferred. Samuelson treated market failure as the exception to the general rule of efficient markets. But the Greenwald-Stiglitz theorem posits market failure as the norm, establishing "that government could *potentially* almost always improve upon the market's resource allocation." And the Sappington-Stiglitz theorem "establishes that an *ideal* government could do better running an enterprise itself than it could through privatization" (Stiglitz 1994, 179)

39. As quoted in Snowdon, Vane, and Wynarczyk 1994, 288.
40. In other words, the causation implied in the marginal productivity theory of wages is reversed in the efficiency wage theorem. Rather than workers being paid according to their marginal productivity, they are productive according to what they are paid.
41. Potential employees are assumed to know more about their work skills and personal qualities than employers. Since the costs of hiring and firing are not trivial, firms are concerned about hiring people they will have to eventually let go because of low productivity. In this situation, the New Keynesian model suggests that applicants who offer to work for less than the efficiency wage will send a signal that they are low-productivity workers. This is a version of adverse selection.
42. Unemployed workers are seen as unable to bid wages down for a variety of reasons that have been summarized as the advantages of insiders (incumbent workers) over outsiders (unemployed workers). The cost of replacing insiders with outsiders is often quite high, including fitting the outsiders into the insiders' work environment if the insiders perceive the threat of wage cuts from the outsiders.
43. Cf. Bellante 1994.
44. In this paragraph I follow Jeffrey Friedman 1996a, 16ff, which elaborates a Weberian, particularistic methodology; but I disagree with ibid., 9, which blames preformalist economics for assuming, rather than investigating, the correspondence of its ideal types with reality.
45. Cf. Jeffrey Friedman 1996a, 12–13; Mayer 1993.
46. After the 1940s, as Robert Solow puts it, "judicious discussion is no longer the way serious economics is carried out" (1997, 42). Model-building has become the standard intellectual exercise.
47. Unless, of course, the purpose of the introduction of such assumptions was to engage in a counterfactual mental experiment.
48. In the new interventionism, one set of assumptions (optimal search, perfect competition, etc.) is replaced by another (asymmetric information, imperfect competition, etc.) and the logical results are derived. The model, not the economy, is the subject under investigation.
49. This, for example, is why Coase is to be contrasted with Stigler or Becker or Posner. The starting point of Coase's analysis was that in general equilibrium the phenomena he sought to illuminate would be absent. The causes of the phenomena must therefore be found in deviations from equi-

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librium—in Coase's case, positive transaction costs. In Mises 1949, this method of contrast is employed throughout to illustrate the functional significance of various market insititutions in a non-equilibrium world of change. By exploring the logic of a world free of change, one can by way of contrast explore the world of change, which would be too complex to examine directly without the help of this mental tool.

50. The same can be said of the direction in which research on market socialism is going. At the moment these models are not as well worked-out as the New Keynesian models. But in the work of Roemer the key issue is one of mechanism design and determining the appropriate monitoring/contractual relationship to align incentives. In short, Roemer is trying to use the rational choice equilibrium framework to solve the problems associated with market socialism. As New Keynesian models increasingly question the efficiency of financial and labor markets under capitalism, the need for Roemerian solutions appears to grow, just as in the 1930s and 1940s the socialist models had a parasitic relationship to Keynesianism.
51. A great deal of contemporary economics refines traditional theory by incorporating more realistic situations, such as increasing returns, multiple equilibria, and findings from experimental economics. In a recent survey of modern economic theory, David Kreps (1997) contends that these developments (especially experimental economics) have the potential of making economics relevant to reality. But, like market failure theory, the point of much of this work is to demonstrate how real-world behavior deviates from the standard equilibrium model. The standard model remains the point of reference, so the passage of time, the generation of new knowledge, and changing conditions have yet to be incorporated.
52. See, for example, Stiglitz 1994, 24–26 and 269–77. Also see John Roemer's 1995 essay review of Stiglitz's book, which he refers to as "An Anti-Hayekian Manifesto."
53. As Karen Vaughn (1994, 178) concludes in her book on the migration of the Austrian school to America, "It seems indisputable that scientific understanding would be much improved if at some point in the future we could genuinely and intelligently say, along with Milton Friedman, there is no such thing as Austrian economics, only good economics and bad economics. But this time we would mean that good economics was an economics not only of preferences and constraints, but also an economics of time and ignorance."

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Steven Lukes

SOCIAL JUSTICE: THE HAYEKIAN CHALLENGE

ABSTRACT: *Hayek's argument that social justice is a mirage consists of six claims: that the very idea of social justice is meaningless, religious, self-contradictory, and ideological; that realizing any degree of social justice is unfeasible; and that aiming to do so must destroy all liberty. These claims are examined in the light of contemporary theories and debates concerning social justice in order to assess whether the argument's persuasive power is due to sound reasoning, and to what extent contemporary theories of justice meet or escape the Hayekian challenge.*

Over two decades ago Friedrich Hayek declared himself convinced that "social justice" is a mirage: an illusory goal whose pursuit, moreover, can only lead to disaster. The expression, he thought, described "the aspirations which were at the heart of socialism"; indeed, "the prevailing belief in 'social justice' is at present probably the gravest threat to most other values of a free civilization" (Hayek 1976, 65, 66–67). "So long as the belief in 'social justice' governs political action," he wrote, "this process must progressively approach nearer and nearer to a totalitarian system" (ibid., 68). The phrase, he declared, embodies a "quasi-religious belief"—"almost the new religion of our time"—but has "no content whatever," and serves

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"merely to insinuate that we ought to consent to a demand of some particular group" (ibid., xi-xii). The advocates of social justice, Hayek claimed, promise to "co-ordinate the efforts of the members of society with the aim of achieving a particular pattern of distribution regarded as just, but trying to do this in a society of free individuals must make that society unworkable" (ibid., 64, 96). In arguing thus, Hayek saw himself as issuing a "challenge which will make it necessary for others to reflect on the meaning of the words they use" (ibid.).

In what follows I shall focus entirely on Hayek's argument for these conclusions. I shall not, except where strictly necessary, consider his wider ideas about philosophy, politics, or economics. My purpose is limited to assessing the strength of his argument against social justice, and thus the strength of the challenge it was meant to pose to all those disposed to think and act in the light of this idea. Hayek observed that the idea of social justice has achieved a kind of pervasive hegemony, influencing not only socialists of all kinds but also Catholics and, indeed, proponents of virtually all contemporary political standpoints. To seek to subvert the very idea of social justice was therefore a typically bold counter-thrust in an ideological war in which Hayek believed that winning conviction through argument could have real political impact.

It is hard to know what that impact has been. It is intriguing to speculate what contribution Hayek's critique of social justice may have made to the widespread appeal of market-based "neo-liberal" ideas and recipes throughout the world, and in particular in Central and Eastern Europe, that has been so evident since the early 1980s. One can, for instance, clearly see its influence in some of the pronouncements of Margaret Thatcher.[1] It probably persuaded those economists and other academics and policy advisers who came under Hayek's influence (notably those involved in the Mont Pèlerin Society)—whose influence, in turn, on policy making in various countries is yet to be charted.

It would seem that its impact within the academic world has, in comparison, been rather restricted. Since the mid-1970s, social justice has indeed become the central focus of normative political philosophy in the English-speaking world, and increasingly beyond it, largely under the influence of the writings of John Rawls. Yet neither Rawls, nor his followers or critics, nor other contributors to the ramifying debates that have flourished over the last two decades

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have paid much attention to Hayek's challenge. For the most part they have viewed his position on social justice as the expression of a political standpoint that is eccentric but not challenging. Even other "libertarian" writings, such as Robert Nozick's *Anarchy, State and Utopia*, whose conclusions converge with Hayek's, do not, for the most part, draw upon Hayek.

A Hayekian, of course, might be untroubled by this neglect, attributing it to the fact that "academic philosophers in their sheltered lives as members of organizations" are inclined to "rationalist constructivism" and have "lost all understanding of the forces which hold the Great Society together" (Hayek 1976, 105). But it could also be that Hayek has no case, and has been neglected justly. I shall investigate this possibility by separating out the various components of Hayek's critique, with the aim of seeing where its strengths and weaknesses lie. In the light of such an examination, we should be in a position to determine to what extent contemporary theories of social justice meet or escape the Hayekian challenge.

The Six Claims

Hayek's initial claim is a semantic one. The term "social justice," he writes, is "entirely empty and meaningless" (Hayek 1976, 11). It "does not belong to the category of error but to that of nonsense, like the term 'a moral stone'" (ibid., 78). This is the first claim:

(1) that the idea of social justice is *meaningless*.

Hayek usually states this claim in a more qualified form, arguing that social justice is meaningless only in certain conditions, namely, "in the Great Society of free men" (ibid., 67). Thus, "in a society of free men whose members are allowed to use their own knowledge for their own purposes the term 'social justice' is wholly devoid of meaning or content" (ibid., 96). More specifically, with respect to the determination of "the prices which must be paid in a market economy for different kinds of labour and other factors of production, . . . considerations of justice just do not make sense" (ibid., 96). In a free society, governed by "the impersonal process of the market," "differences in reward simply cannot meaningfully be described as just or unjust" (ibid., 70). By contrast, "social justice" "can be given meaning only in a directed or 'command' economy

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(such as an army) in which the individuals are ordered what to do" (ibid., 69). Hence Hayek's modified first claim:

(1a) that the idea of social justice is *meaningless in a free, market-based society.*

In some passages, however, Hayek allows that "social justice" does, after all, have a certain kind of meaning, even perhaps in a free society, namely a religious or "quasi-religious" or "superstitious" one, comparable to the "general belief in witches or ghosts" (Hayek 1976, 66). It is, he maintains, "a sign of the immaturity of our minds that we have not yet outgrown these primitive concepts" (ibid., 63). Hayek suggests that "the moral feelings which express themselves in the demand for 'social justice' derive from an attitude which in more primitive conditions the individual developed towards the members of the small group to which he belonged" (ibid., 88). Hence his second claim:

(2) that the idea of social justice is *religious.*

Hayek also advances the view that justice (and injustice) may be "predicated about the intended results of human action but not about circumstances which have not deliberately been brought about by men" (Hayek 1976, 70). It cannot be attributed to the consequences of an impersonal process that "are not intended or foreseen, and depend on a multitude of circumstances not known in their totality to anybody" (ibid., 70). Justice and injustice are thus "inapplicable" to "the results of a spontaneous process"; if injustice is being claimed, it must make sense to ask, "Who is supposed to have been unjust?" (ibid., 67, 93). More specifically, "the manner in which the benefits and burdens are apportioned by the market mechanism" are not unjust (nor are they just) (ibid., 64); the conduct of individuals in "the impersonal process of market allocation" may well be "just or unjust," but "since their wholly just actions will have consequences for others which were neither intended nor foreseen, these effects do not thereby become just or unjust" (ibid., 70). The contrary supposition—that "the results of the spontaneous ordering of the market" are capable of being just or unjust—derives from "that anthropomorphism or personification by which naive thinking tries to account for all self-ordering processes" (ibid., 62–63). Society becomes "the new deity to which we complain and clamor for redress if it does not fulfil the expectations it has created" (ibid., 69). But, in a free society, there is "no human agency" responsible for "differences in human fates" (ibid., 68), no "personal

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distributing agent whose will or choice determines the relative position of the different persons or groups" (ibid., 72), and thus "no individual and no co-operating group of people against which the sufferer would have a just complaint"—and "no conceivable rules of just individual conduct which would at the same time secure a functioning order and prevent such disappointments" (ibid., 69). In short, since social processes are impersonal while justice presupposes the deliberate agency of a person or persons, Hayek's third claim is

(3) that the idea of social justice is *self-contradictory*.

As a corollary, Hayek maintains (in an appendix to the chapter in *Law, Legislation, and Liberty* on social justice) that although we have time-honored political and civil rights—"negative rights . . . protecting individual domains," and "positive rights" to participate in the direction of governmental organization—there are no "positive 'social and economic' human rights" or "claims to particular benefits to which every human being as such is presumed to be entitled" (Hayek 1976, 103). No one has a "claim to justice on 'society' for the provision of particular things which it is the duty of that society to provide": justice "does not impose on our fellows a general duty to provide for us[,] and a claim to such provision can exist only to the extent that we are maintaining an organization for that purpose." Society, "which produces the means for the satisfaction of most of our needs[,] is not an organization directed by a conscious will, and could not produce what it does if it were." Thus it is "meaningless to speak of a right to a condition which nobody has the duty, or perhaps even the power, to bring about," and it is "equally meaningless to speak of right in the sense of a claim on a spontaneous order, such as society, unless this is meant to imply that somebody has the duty of transforming that cosmos into an organization and thereby to assume the power of controlling its results." Since society is a "spontaneous order" and since nobody "has a right to a particular state of affairs unless it is the duty of someone to secure it" (ibid., 102), Hayek claims

(3a) that the idea of social and economic rights is also *self-contradictory*.

Hayek further maintains, in an unmasking or debunking spirit, that appeals to social justice are *really* just disguised ways of expressing the "demand of some particular group" (Hayek 1976, xii). Thus, "almost every demand for government action on behalf of particu-

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lar groups is advanced" in the name of social justice, with the result that "opposition to it will rapidly weaken" (ibid., 65). Governments feel compelled to satisfy "the claims of the ever increasing number of special interests who have learnt to employ the open sesame of 'social justice'" (ibid., 67). It becomes "a humbug—the effectiveness of which with well-meaning people the agents of organized interests have learnt successfully to exploit" (ibid., 90). Far from "an innocent expression of good will towards the least fortunate," it has become "a dishonest insinuation that one ought to agree to a demand of some special interest which can give no real reason for it" (ibid., 97). In short, Hayek's fourth claim is

(4) that the idea of social justice is *ideological.*

Hayek also asserts that it is impossible "to preserve a market order while imposing upon it (in the name of 'social justice' or any other pretext) some pattern of remuneration based on the assessment of the performance or the needs of different individuals or groups by an authority possessing the power to enforce it" (Hayek 1976, 37). Hayek makes two arguments for this assertion. The first is that in a free society, agreement can never be secured as to what counts as satisfactory performance, or need, or merit, or desert, or value to society; nor, more seriously, can there be agreement as to how to rank these: there is no "single hierarchy of ends," and "the values attached to the different services by different groups of people are incommensurable" (ibid., 76). Moreover, even if such agreement could be secured, no government or planning agency could have access to the knowledge it would need successfully to implement such a pattern. Were such a conception realizable, it would imply "that the processes of society should be deliberately directed to particular results" by "a subject endowed with a conscious mind capable of being guided in its operations by moral principles," yet this is impossible (ibid., 79). Hence Hayek's fifth claim:

(5) that a socially just market order is *unfeasible.*

Finally, Hayek maintains that what are all too feasible are pressures upon, and misguided attempts by governments to achieve, some "recognizable scheme of distributive justice" (Hayek, 1976, 68). But "the more governments try to realize some preconceived pattern of desirable distribution, the more they must subject the position of different individuals and groups to their control. So long as the belief in 'social justice' governs political action, this process must progressively approach nearer and nearer to a totalitar-

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ian system" (ibid.). Hayek concedes that "the highly interventionist 'mixed' economy existing in most countries today" results from "governmental measures aiming at what was thought to be required by 'social justice'" (ibid., 81); his dark prophecy is that aiming further in this direction can only lead to "a totalitarian system in which personal freedom would be absent" (ibid., 76). Hence Hayek's sixth claim:

(6) that striving for social justice is *disastrous*.

Assessing Hayek's Critique of Social Justice

How strong are the separate threads of Hayek's argument, and how strong is the fabric that results from their combination?

Considering first the structure of the argument as a whole, it seems clear that claims (1) and (2) rest on (3). In other words, the claims that "social justice" is nonsensical or religious depend on the thought that the very phrase combines terms which, given their rightly understood meanings, cannot properly be combined. Thus to speak of "social justice" (as of a "moral stone") is either to commit what Gilbert Ryle used to call a "category-mistake," applying "concepts to logical types to which they do not belong" (Ryle 1949, 17), or else it is to utter an unfathomable mystery. Yet it also seems clear that claims (1)–(3) are, at the very least, in tension, if not in contradiction, with claims (4)–(6), since these latter claims imply that talk of social justice is misleading, mistaken, and misconceived, and thus *capable* of being understood. Indeed, the main thrust of Hayek's argument must surely be to convince his readers not to accept the case for pursuing social justice, not to persuade them that it is unintelligible.

But let us take claims (1) and (1a) at face value: namely, the charge that to associate "social" with "justice" is a category mistake. To make this charge is simply to posit a definition of "society" as "spontaneous" and governed by "the impersonal process of the market," and a definition of "justice" as inapplicable to the consequences of an impersonal process. These definitions are not "logical types" but, as we shall see, highly contested stipulations.[2]

As for claim (2), that "social justice" has, after all, a *religious* meaning, three points need to be made, of which the first two are *ad hominem*. In the first, place, Hayek's equation of religion with super-

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stition and primitive thought, and with belief in witches and ghosts, seems to be at the least in tension with the Burkean critique of Enlightenment-inspired scientism to be found in Hayek's *The Counter-Revolution of Science* (1952). Second, and even more strikingly, it seems to contradict his later explicit statements about the evolutionary benefits of religious beliefs:

> Custom and tradition, both non-rational adaptations to the environment, are more likely to guide group selection when supported by totem and taboo, or magical and religious beliefs—beliefs that themselves grew from the tendency to interpret any order men encountered in an animistic manner. (Hayek 1988, 136)

According to the later Hayek, "we owe our morals, and the tradition that has provided not only our civilization but our very lives, to the acceptance of such scientifically unacceptable factual claims" (ibid., 137). (Contrast Sir Karl Popper, who defines the open society and the extended order by their very rupture with such beliefs.) In short, it is not clear why, for Hayek, the *religious* meaning of "social justice" is, in itself, an objection to it.

Nor, thirdly, is it clear why giving "social justice" a religious meaning should be objectionable in any case. If all that is meant is that social justice may be treated as a *sacred* value to which (certain) other values are *sacrificed*, within certain limits, rather than merely traded off, there seems to be no harm in acknowledging that social justice may be given a "religious" or "quasi-religious" significance (see Lukes 1996 and 1997).

What are we to say of claim (3), that the attribution of justice and injustice presupposes deliberate action that produces effects that are intended and foreseen, and that the results of social or impersonal processes are therefore immune to judgments in terms of justice and injustice? Two responses are appropriate, one dealing with individuals' "social" obligations, the other with the evaluation of impersonal systems of rules. First, notice that Hayek's argument contains an ambiguity in respect of *what* is being judged: the situation or our response to it. A state of affairs that no one has intended or foreseen may, nevertheless, require action to alleviate suffering or deprivation, and failure to take such action may be justly condemned as unjust. Judith Shklar has made this point well:

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> It is evident that when we can alleviate suffering, whatever its cause, it is passively unjust to stand by and do nothing. It is not the origin of injury, but the possibility of preventing and reducing its costs, that allows us to judge whether it was or was not unjustifiable passivity in the face of disaster. (Shklar 1990, 81)

Hayek himself admits this important point when he allows that governments should provide a guarantee against severe deprivation in the form of an assured minimum income, arguing that "it may be felt to be a clear moral duty of all to assist, within the organized community, those who cannot help themselves" because they are "unable to earn in the market an adequate maintenance" (Hayek 1976, 87). One's inability to earn an adequate income is surely either one's own doing or the "fault" of the market order in which one finds oneself, not the doing of those Hayek would force to remedy the situation. It appears, therefore, that Hayek concedes that people may have obligations to help each other even when those so obliged did not cause the distress to be alleviated—indeed, when this distress is the result of an impersonal, spontaneous order.

Secondly, we must ask whether it is, in any case, convincing to argue, as Hayek does, that situations resulting from actions neither intended nor foreseen by agents to bring them about are immune to moral appraisal in terms of justice and injustice. Consider typical cases of decision making within a framework of rules that results in an outcome worse for everyone than an alternative attainable within a different framework. Examples are the deleterious effects of private enclosures of the English "commons," and overfishing outside of territorial waters caused by the distribution of fishing rights within them. There are innumerable other cases of perverse or suboptimal effects resulting from inadequate rules to govern individuals' pursuit of their particular interests. In such cases, what may legitimately be judged unjust is the very framework of rules that yields such combined effects, which are neither intended nor foreseen nor the result of a concerted will. All that is required for such judgments to be appropriate is the existence of feasible alternative rules that would lead to better results. Markets always operate within regulative frameworks, both legal rules and informal norms—regulative frameworks that could be different. The misleading language of "spontaneity" and "deregulation" can all too easily obscure this elementary truth, which Durkheim expressed

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long ago when he observed that freedom of contract "is only possible because of the regulation of contracts" (Durkheim [1893] 1984, 162).

As with the question of whether there are enforceable obligations on individuals who did not cause the problems they are compelled to alleviate, Hayek contradicts his claim that impersonal orders should not be judged against standards of justice by using just such a standard—a utilitarian standard—to justify the paradigm case of a spontaneous order, the market.[3] The market, he writes, "brings about a greater satisfaction of human desires than any deliberate human organization could achieve"; it improves "for all or most the prospects of having their needs satisfied"; it determines "a size and composition of the total output which assures that the real equivalent of each individual's share that accident or skill assigns to him will be as large as we know how to make it" (Hayek 1976, 63, 64–65, 72). This shows, first, that according to Hayek, at least the general effects of the market process are, after all, foreseeable; and, second, that for Hayek himself, they are subject to judgments with respect to justice and injustice.

Hayek's fourth claim, that the very idea of social justice is inherently ideological—universal in form but always advancing some particular, partial interest—can be seen as a corollary of claims (5) and (6), to be considered below: that is, as following from the alleged unfeasibility of implementing any scheme of social justice, and from the allegedly totalitarian consequences of trying to do so. The suggestion would be that advocates of the idea, knowing these things, can only be deceiving their addressees, in order to benefit through such deception. If, however, it turns out on inspection that claims (5) and (6) are less than convincing, this suggestion will in turn lose whatever persuasive power it may have had.

Alternatively, claim (4) may be interpreted as expressing a generalized skepticism about whether anyone could genuinely be motivated by the desire to secure greater distributive justice—even though they may pointlessly "complain to God or fortune about the injustice of their fate" (Hayek 1976, 81). In contrast to most other defenders of capitalism (such as Robert Nozick and Irving Kristol), Hayek's official position is that the distribution of benefits and burdens in a free society can be *explained* as the combined result of skill, industry, and luck, but can never be *justified*. Thus, he

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systematically suspects the motives of those who appeal to impartial principles of social justice to which all could reasonably subscribe.

Now it is true that this motive is assumed to be widely operative by virtually all contemporary theorists of social justice in respect of the institutions that determine the distribution of the benefits and burdens of social cooperation. Rawls (1972, 46) assumes that "each person beyond a certain age and possessed of the requisite intellectual capacity develops," under "normal social circumstances," the extraordinarily complex moral capacity he calls the "sense of justice"; Thomas Scanlon (1982, 117) remarks that "the desire to be able to justify one's actions (and institutions) on grounds one takes to be acceptable is quite strong in most people. People are willing to go to considerable lengths, involving quite heavy sacrifices, in order to avoid admitting the unjustifiability of their actions and institutions." Brian Barry (1995, 164) calls this "the agreement motive": "the desire to live in a society whose members all freely accept its rules of justice and its major institutions." Charles Larmore (1987) assumes that such agreement may be achieved by citizens setting aside their differences and adopting a neutral stance. Jeremy Waldron (1993, 61) believes that liberals "demand that the social order be capable of explaining itself at the tribunal of each person's understanding." Jürgen Habermas maintains that in putting forward claims as just, we imply that they could command the unforced assent of all others affected, under ideal conditions. What is striking is that Hayek also accepts such reasoning when he declares himself to have no quarrel with Rawls's view that "the principles of justice define the crucial constraints which institutions and joint activities must satisfy if persons engaging in them are to have no complaints against them" (Rawls 1963, 102, quoted in Hayek 1976, 100).[4]

Hayek offers, as we have seen, two arguments for his claim (5), that realizing any kind of social justice is unfeasible. The first consists in the assertion of value incommensurability and the denial of a hierarchy of ends. But this assertion and denial are common ground, indeed the common starting point, of most contemporary theorists of justice and virtually all the liberals among them. Thus Rawls—and in particular the later Rawls of *Political Liberalism*—is specifically concerned to stress the idea of justice as publicly impartial or neutral among contending conceptions of the good: in his conception, just arrangements will not favor in advance any particular criterion for assessing "the performance or the needs of differ-

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ent individuals or groups," nor will they rely on ordering these within the framework of any "comprehensive" conception of the good. Of course, not all are in agreement with Rawls's solution, and some dispute the goal of neutrality or impartiality itself. But no one other than Hayek takes value incommensurability and value pluralism to subvert the very idea of social justice, and it is difficult to understand why they should.

The other argument for (5), that no political authority could have access to the knowledge needed to realize any form of just redistribution, is the one that is most obviously linked to Hayek's own major distinctive intellectual contribution. Whatever the final judgment about the value of this contribution, it has certainly shown that socialist and other theorists and practitioners of economic planning underestimated the epistemological significance of markets and vastly overestimated their capacities to bypass these. But to extend the argument against socialism to one against mixed economies is merely rhetorical (cf. Hirschman 1991). For Hayek cannot show that governments or planning authorities are so radically ignorant of relevant information that their every attempt to modify the distribution of rewards resulting from market processes must always be futile. For one thing, to show this would require that Hayek had access to the very knowledge (about the interactions of unintended consequences) that he declares to be inaccessible. For another, the argument assumes that implementing greater social justice can take only the form of a "command economy," an assumption that leads us to his sixth and final claim.

Hayek explicitly states that "'social justice' can only be given a meaning in a directed or 'command' economy" (1976, 69). It involves governments singling "out some people in . . . a society as entitled to a particular share," subjecting "the position of the different individuals and groups to their control" (ibid., 65, 68). The government would have "to undertake to tell people what to do," so people would be subject to "the commands of the directing authority," which, "to achieve particular results for the individuals[,] must be given essentially arbitrary powers to do what seems necessary to achieve the required result" (ibid., 86, 82, 83). In short, "if 'social justice' is to be brought about, the individuals must be required to obey not merely general rules but specific demands addressed to them only" (ibid., 85).

Hayek contrasts this nightmare with what he claims to be the

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only alternative, namely, the "rule of law," governed by the "comprehensive formula that no coercion must be used except in the enforcement of a generic rule applicable to an unknown number of future instances." This constraint on the rule of law means that it "cannot produce a duty of the governments to bring about a particular state of affairs" (Hayek 1976, 102). As he understands it, the rule of law amounts to a presumption in favor of general rules and against discretionary power (cf. Brittan 1983, 63). This is perhaps the key to Hayek's entire political philosophy: justice not as fairness but as the elimination of arbitrary coercion. Recall that Hayek's definition of liberty is "the state in which a man is not subject to the arbitrary will of another or others" (1960, 11). The "constitution of liberty" is a regime of general, abstract rules equally applicable to all. Hayek makes the Kantian assumption that these formal rules will select out a narrowly limited range of laws that will be consented to by all those not blinded by partiality or prejudice. He also makes the Humean assumption that within this range, a system or rules can be selected that will best facilitate human purposes, and he believes that this system will turn out to be one that accords priority to the protection of liberty (cf. Gray 1989).

These assumptions, however, cannot be sustained. It is only under specially favorable, fair-weather conditions that liberty-protecting rules will also maximize utility. The formal requirements of generality, abstractness, and equality of application are not sufficient to rule out illiberal legislation (nor does Hayek's test of consent solve this problem: it is not difficult to think of cases where people will consent to oppressive legislation). Repressive, arbitrary laws can easily take an abstract and general form and be applied equally, as in the case of apartheid. For, as Samuel Brittan has remarked,

> general rules must mention categories: traffic laws deal with motor cars, sales taxes make traders liable and so on. Once this is admitted, it is very difficult to see how rules can be prevented from singling out occupations or industries, nor is it necessarily always desirable that they should be prevented from so doing. But once we have gone along this road a supposedly general law may well pick out for especially severe treatment a group or even a single individual. (Brittan 1983, 64)

More importantly, Hayek has not shown that social or distributive justice *must* be arbitrary, involving "specific directives" that sin-

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gle out "different individuals and groups." What Hayek legitimately objects to are attempts by governments and planning agencies to assess merit or desert or the "value to society" of different occupations, and he rightly scorns the notion, dear to many ideologists of capitalism (such as Irving Kristol), that differential rewards under capitalism are deserved. But his argument goes far beyond this, seeking to discredit any public direction of the distribution of income and property beyond the provision of a bare social security minimum. What he altogether fails to show is that redistribution must involve arbitrary interference with individuals seeking "to use their own knowledge for their own purposes."

For redistributive policies can take the form of modifying the shape of an income or property distribution without any mention of merit or occupation, or any reference to specific groups or individuals, by using such policy instruments as taxes (positive and negative), social security payments, and the laws of property and inheritance. The effect of such devices is solely to compress the post-tax distribution of income and property, and thus implies no "arbitrary interference." Nor, secondly, is there any good reason to maintain that "reassignment" policies, which seek to change people's position within existing income and wealth scales, must have such an implication. To call such policies "arbitrary" is simply to declare a predisposition against all "targeted" policies for no better reason than that any target must be selected according to some criterion (and would thus be a step on the slippery slope towards the completely arbitrary criteria of a totalitarian system). Indeed, Hayek himself suggests an appropriate, if very general, criterion for the targeting of redistributive policies, namely, improving the circumstances that render people unable "to use their own knowledge for their own purposes." Yet Hayek nowhere addresses the crucial question of the extent to which both kinds of redistributive policies may be necessary in order to render acceptable—that is, to legitimate, on grounds of social justice—the persistent and growing inequalities of resources and opportunities that are everywhere inherent in market economies.

* * *

We can only conclude that Hayek's celebrated and apparently influential argument does not establish that the very idea of social justice is meaningless, religious, self-contradictory, and ideological; or

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that realizing any degree of social justice is unfeasible; or that aiming to do so must destroy all liberty. Social justice has not yet been shown to be a mirage. The Hayekian challenge to the modern liberal state must lie elsewhere if it is to succeed.

NOTES

1. As when she famously remarked that "there is no such thing as 'society.'"
2. "By 'stipulative' word-thing definition . . . I mean the explicit and self-conscious setting up of the meaning-relation between some word and some object, the act of assigning an object to a name (or a name to an object), not the act of recording an already existing assignment" (Robinson 1954, 59).
3. The version of utilitarianism that Hayek espouses is that which maximizes average expectations: thus, "the good Society is one in which the chances of anyone selected at random are likely to be as great as possible" (Hayek 1976, 132). This is the principle that Rawls considered to be one of the main rivals to his own.
4. Later, Hayek seems to have changed his mind about Rawls: see Hayek 1988, 74.

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David Johnston

HAYEK'S ATTACK ON SOCIAL JUSTICE

ABSTRACT: *Hayek assailed the idea of social justice by arguing that any effort to realize it would transform society into an oppressive organization, stifling liberty. Hayek's view is marred by two omissions. First, he fails to consider that the goal of social justice, like the goal of wealth generation, might be promoted by strategies of indirection that do not entail oppressive organization. Second, he underestimates the tendency of the market order itself to generate oppressive organization, and consequently sees advantages in the market order that it may not possess.*

Friedrich von Hayek first gained a reputation outside narrow professional circles with the publication of *The Road to Serfdom* in 1944. In this and the other works that he produced until his death nearly half a century later, Hayek established himself as a scathing critic of fascism, communism, and all forms of collectivism, and an ardent defender of liberal market society. Hayek was not a defender of the liberal principle of laissez faire.[1] Nevertheless, his most distinctive claim, the one that won him both fame and notoriety, was that democratic socialism, which many observers have viewed as an attractive "middle way" between the excesses of unrestrained capi-

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talist competition and the horrors of totalitarian collectivism, is in reality a stage on the road to the latter. This repudiation of democratic socialism was bound up with a rejection of its egalitarian ideals. According to Hayek (1976, 136), the aspiration for social justice "has been the Trojan Horse through which totalitarianism has entered." Hayek endorses the proposition that governments should make provisions for the welfare of the poorest members of society.[2] Yet in his view, it is a fundamental error to treat substantive equality or social justice as a goal of the social order.

Why did Hayek conclude that the pursuit of substantive equality is such a dangerous error? At bottom, the answer is that, like Lord Acton, he considered the goal of material or substantive equality to be incompatible with liberty. Liberty presupposes the rule of law, but Hayek argues in *The Road to Serfdom* (1944, 79) that "any policy aiming directly at a substantive ideal of distributive justice must lead to the destruction of the Rule of Law." In subsequent works Hayek elaborated this claim by developing a theory of social order based on a dichotomy between the key concepts of "organization" and "spontaneous order."

In this essay I contend that the arguments Hayek offers against adopting the goal of substantive equality are unsuccessful. While they contain shrewd insights that are vital for the analysis of social systems, his attack on equality succeeds only as a critique of a particular type of *strategy* for attaining equality, namely the strategy of directly imposing egalitarian outcomes as a matter of state policy. As a critique of the *goal* of substantive equality or social justice, Hayek's argument fails.

Organized vs. Spontaneous Order

Since Hayek's argument against the goal of substantive equality draws upon his general theory of social order, it is important to understand the basic elements of that theory in order to assess his claims. According to Hayek, two fundamentally different types of social order exist.[3] The first and more familiar type is what Hayek calls a "made order" or an *organization*. A made order is the product of someone's deliberate design. This type of order tends to be hierarchical in structure. It is maintained principally by relations of command and obedience. Above all, it is *purposive*, that is, oriented

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toward the achievement of a particular goal. The goals of different organizations are various; while one organization may be devoted to the maintenance of national defense, another may be dedicated to the provision of charitable relief for poor or disabled people. Whatever particular purpose an organization may have, that purpose tends to dominate its operations. The diverse individuals who compose the organization must subordinate their own particular and often idiosyncratic purposes to the aims of the organization if their continued participation in its operations is to be assured.

It is not unusual to suppose that organization or made order is the only type of social order human beings are capable of sustaining and to assume that, where a social order exists, it must have been a product of deliberate design. According to Hayek, however, human beings routinely create social orders of a different kind, which he calls "grown order" or *spontaneous order.* Spontaneous orders are orderly in giving rise to actions that are reasonably predictable; they make it possible for their participants to form expectations about the consequences of their own actions that are likely to prove correct. Yet they are spontaneous in that they are not the products of anyone's deliberate design. They are maintained, characteristically, by relations of mutual adjustment, give and take, and reciprocity rather than by relations of command and obedience. Most important, since spontaneous orders are not designed at all, they are not designed to serve any single concrete goal. They are means, or they help individuals to acquire the means, to pursue their own diverse purposes, but they are devoted to no overriding purpose of their own.

Organizations and spontaneous orders normally coexist and are interdependent. Spontaneous orders are dependent on the existence and enforcement of a framework of rules—Hayek calls them the rules of just conduct—that are applied equally to all persons in a society. But the enforcement of such rules requires an organization, normally a government. So at least some organization is a presupposition of any spontaneous order. At the same time, no society can be ordered successfully by organizations alone. One major reason for this fact is epistemological in character. Because organizations are devoted to the achievement of particular goals or purposes, they foster a limited range of vision and are capable of collecting and responding only to information that falls within that range. Any information that falls outside the organization's scope is likely to be

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discarded or, even more probably, to go unnoticed in the first place. Moreover, organizations are capable of helping people to pursue only a limited range of ends. Since the concrete ends of real human beings are highly diverse, and since in general human beings disagree about ends,[4] the most useful organizations are those designed to pursue goals about which broad agreement exists. When agreement fails, as it does on most subjects in modern societies, spontaneous order may be a more appropriate means of achieving order than organization, since spontaneous orders enable people to pursue their own diverse purposes.

Since spontaneous orders, unlike organizations, have no overriding purpose of their own, it is impossible in principle to predict the overall outcome of a spontaneous order in action. In this sense a spontaneous order is like a competitive game that involves an element of chance. To the extent to which a competitive game also involves an element of skill, we can make reasonable predictions about its outcome based on our knowledge of the players' skills. But we cannot actually know what the outcome will be in advance; if we could, then the game would have no point. (When competitive games are played by opponents with known, sharp differences in levels of skill, they often do seem pointless.) A game of this type is regulated, ideally, by strict adherence to its rules, and the outcome of the game is fair if those rules have been observed throughout. Similarly, in Hayek's view, a spontaneous order is ideally regulated by strict enforcement of its rules, and the outcome or consequences of such an order are just if those rules have been observed consistently.[5] The status of rules in an organization is quite different. In an organization, a desired outcome—a goal—is stipulated in advance. Ideally, the rules of the organization are designed to achieve that outcome. If those rules fail to deliver the desired result, then they may be changed without threatening the purpose of the organization; indeed they *must* be changed in order to accomplish that purpose. What matters in an organization, as Hayek conceives it, is whether its goals are achieved.

Thus, spontaneous orders not only *lack any central organizing purpose* distinct from the purposes of the individuals who constitute them; they are also *non-hierarchical in structure* and possess *an integrity that is guaranteed by adherence to fixed rules*. In contrast, organizations are *oriented toward a particular goal*, are *hierarchical in structure*, and possess *relatively plastic rules and procedures that are legitimated instrumen-*

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tally by reference to their goals. These characteristics of spontaneous orders and organizations are the most salient features of Hayek's theory of social order for his argument against the goal of substantive equality.

That argument runs as follows. A society whose members are largely free to pursue their own ends and purposes without subordinating those purposes to any other person or body constitutes a spontaneous order. The fairness of any set of interactions among the members of such an order can be guaranteed if they all adhere over time to publicly known rules (the rules of just conduct) that apply in the same way to everyone. Since individuals' ends are diverse and, for the most part, unknown to any given observer, it is impossible to know in advance the overall outcome to which such a set of interactions will lead.

By contrast, the idea of substantive equality defines a particular, determinate outcome. No spontaneous order can be expected to yield any such outcome. So the only way to guarantee the attainment of substantive equality would be to rely on an organization that adopts social equality as its goal. The rules that prevail within organizations are legitimated instrumentally, and if they fail to achieve a stipulated goal, they must be changed or overruled. But if rules that regulate individuals' actions are adjusted or ignored whenever necessary to guarantee the attainment of a stipulated outcome, that fact would make it impossible for people to adhere to publicly known rules that apply in the same way to everyone over time. Under these circumstances, it would be impossible to maintain a set of rules of just conduct that apply to everyone in the same way consistently over time. The absence of consistent and effective rules of just conduct would undermine the procedural fairness of a spontaneous order.

In fact, the consequences of any serious effort to guarantee substantive equality would be even worse than those already suggested. For in order to attain this goal, a society would have to take on the major features of an organization. Since organizations are hierarchical, the relations of reciprocity and mutual adjustment that are characteristic of a spontaneous order would be replaced, perhaps subtly and incrementally, by relations of command and obedience. Individuals would have to subordinate their ends to the purposes of the organization (the society), and much of their precious liberty would be lost.

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Hayek's argument, if correct, deals a sharp and probably mortal blow to the ideal of substantive equality, which would hold little attraction if it could be purchased only at the cost of severe regimentation and a sacrifice of the freedom of individuals to pursue their diverse ends. But is Hayek's critique of the goal of equality on target?

Hayek's Instrumentalism vs. His Inegalitarianism

Hayek is known not only as a critic of the ideas of social justice and substantive equality, but also as a staunch defender of the market order. Yet his defense of the market is in sharp tension with his argument against the goal of social equality.

Hayek argues for the market order on two grounds. First, as a species of spontaneous order, the market enables people to engage in cooperative activities without the need for agreement on ends.[6] People commonly assume that social cooperation is impossible in the absence of agreement on a scale of particular values. This assumption, though deeply rooted in the history of human thought, is erroneous. The practices of barter and exchange make it possible for human beings to engage in collaborative endeavors without agreement on concrete ends or purposes, and the market order is the principal vehicle for this kind of cooperative activity. Second, the market order generates great wealth. While people often disagree about the value of ends, they can broadly agree on the value of means. Following Adam Smith closely, Hayek maintains that the market order leads to the generation of means—wealth—to an extent that far exceeds the potential of any known alternative type of economic order. The availability of a relatively abundant stock of means greatly enhances the chances of all to have their wants satisfied. The outstanding capacity of the market order to generate wealth constitutes its second and critically important advantage.[7]

These two arguments in defense of the market order draw on contrasting aspects of that order. The first argument emphasizes the fact that the market is a type of spontaneous order, imposing no overriding purpose of its own but merely enabling people to pursue their own purposes with reasonably accurate expectations about the likely consequences of their actions. This argument calls attention to the fact that market outcomes are indeterminate, since they

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are the products of individuals' diverse ends and purposes. By contrast, the second argument emphasizes a particular determinate outcome of the market, namely its alleged ability to produce more wealth than alternative forms of economic order. The ultimate claim behind both arguments is that the market contributes to the satisfaction of human wants. But the two arguments point to distinct ways in which it does so by emphasizing two different features of that order. And the second of these features is at odds with Hayek's attack on the goal of social equality. For the claim that the market generates *greater aggregate* wealth than any alternative economic order constitutes a prediction about a determinate outcome of a spontaneous order. If the market order can be defended by reference to this particular outcome, it is not evident why other particular outcomes, such as the generation of an *equal distribution* of wealth, could not constitute a valid basis for the defense of alternative social arrangements.

It is true that the generation of great aggregate wealth is not, or at least was not originally, a deliberately intended outcome of market orders, a point Adam Smith emphasized in *The Wealth of Nations*.[8] It might be argued, then, that the *outcome* of wealth-generation is not comparable to the *goal* of social equality, since the former is an unintended consequence of a real social order while the latter is an intended consequence of a possible (or imaginary?) social order. But this argument does not constitute a good reason for rejecting the goal of social equality. For in making his defense of the market order on instrumentalist grounds, Hayek opens the door to judging social arrangements by their success in achieving goals that may be more important than the one—wealth maximization—that the market supposedly achieves. In choosing to validate market outcomes according to the standard of wealth maximization, Hayek does what any social philosopher must do if he is to avoid an irrational approbation of an order merely because it was *not* consciously designed: he posits a goal that serves as the yardstick by which the order's outcomes are evaluated. Why, then, should we refrain from evaluating the market according to an alternative goal, such as the egalitarian goal of "social justice"?

Hayek argues with considerable zeal and consistency that the goal of social equality presupposes "a hierarchy of ends, a comprehensive scale of values in which every need of every person is given its place . . . in short . . . a complete ethical code in which all the different

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human values are allotted their due place;"[9] but that "no such complete ethical code exists" (Hayek 1944, 57–58). The market order is attractive to him in part because it requires no such ethical code, no agreement on ends, but only an agreement on means, an agreement he thinks can be achieved precisely because it would not require knowing what ends they will serve (Hayek 1976, 3, 109–11). So again it may seem that the goal of social equality is dissimilar to the goal of maximizing aggregate wealth. Whereas the former goal refers to a particular concrete end,[10] the latter refers only to relatively abstract means on which people can generally agree.

As an argument against the goal of social equality, this line of reasoning is flawed. It is true that wealth is merely a means that enables people to pursue a range of possible ends. In this sense the generation of great aggregate wealth is not a "particular" end. However, much the same thing could be said about an *equal* distribution of wealth: such a distribution would not presuppose agreement on the ends to which that wealth should be applied. An egalitarian distribution of wealth is as "open" or "purposeless" a goal, and requires as little by way of agreement on ultimate ends, as the goal of maximizing aggregate wealth.

The choice between these two social goals—the maximization of aggregate wealth and the equalization of its distribution[11]—must ultimately be made on normative grounds. Hayek would not accept this claim. In his view, the differences between socialists and defenders of the liberal market order stem from disagreements about the actual workings of society rather than from normative sources.[12] It is certainly true that many differences about social order are products of disagreement about the workings of society, but it is implausible to suppose that all these differences stem from that source.

Hayek might claim that normative arguments about distributive justice are rendered otiose by the fact that the least well-off participants in a market order are likely to be better off than the most privileged members of an economically backward society. Adam Smith ([1776] 1937, 12) famously remarks that

> the accommodation of an European prince does not always so much exceed that of an industrious and frugal peasant, as the accommodation of the latter exceeds that of many an African King, the absolute master of the lives and liberties of ten thousand naked savages.

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From time to time Hayek echoes this comment in his works. It might seem, then, that the sole basis for choosing among social orders must be a proper understanding of their operations and consequences. For it does not seem plausible that anyone considering two societies of the kinds Smith describes would find it difficult to select the wealthier one, even if the poor society were highly egalitarian and the wealthy society were not.

No doubt the correct choice between these two societies is obvious. But we are not likely to find ourselves in a position of having to choose between a social order that is extremely underdeveloped economically and a highly productive market order. Insofar as we are able to choose among social orders at all, our choice is more likely to be between one that generates maximum aggregate wealth without regard to its distribution and one that generates a more egalitarian distribution of wealth. Of course some might argue, and Hayek occasionally comes close to suggesting, that if we maximize aggregate wealth generation, we are likely to enhance the material circumstances of the least favored members of society as well. Whether or not this suggestion is accurate is a matter that can be settled only by empirical investigation. *A priori*, however, there is no good reason to assume that for a given society, the economic structure that would generate the greatest aggregate wealth would also maximize the material well-being of the society's least well-off members. While some positive correlation between aggregate wealth and the material well-being of the poorest members of society might reasonably be expected, it would be a remarkable coincidence if the economic structures that maximize the former were also consistently to maximize the latter.

Hayek's first and broadest line of reasoning against the idea of substantive equality as a social goal, then, appears to be irreconcilable with one of his two major arguments in defense of the market order, namely that that order generates greater aggregate wealth than any likely alternative. But this irreconcilability is only a sign of a larger difficulty with his argument. The source of this difficulty lies in Hayek's assumption that the achievement of collective goals entails an organization charged with the task of accomplishing those goals.[13] In the case of some goals, this assumption is probably correct. For example, it seems unlikely that laws to defend what Hayek calls the rules of just conduct could be adopted and enforced in the absence of legislative and judicial institutions of the

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organizational type. For other goals, however, Hayek's assumption seems to be false. The example of aggregate wealth generation demonstrates this conclusion. If Hayek's assumption were correct, then the only way we could maximize the generation of aggregate wealth would be by creating an organization devoted to that end. Yet Hayek himself suggests that this end is best achieved by the market order rather than by an organization. While the market order can be sustained only within a framework of rules that must be enforced by an organization, it is itself a spontaneous order, one that, as a whole, is not the product of anyone's deliberate design and is maintained primarily by relations of mutual adjustment and reciprocity. Hayek's own defense of the market order on the ground that it generates great wealth belies his assumption that collective goals can be pursued effectively only by means of organization.

Of course it is possible to *attempt* to achieve social justice by means of organization and direct imposition. This type of means has in fact been the preferred method of pursuing nearly all social goals throughout recorded history. In the case of social justice, however, these efforts have had limited success. One systemic reason for this fact is that the direct imposition of a relatively egalitarian distribution of wealth can be accomplished only by an act of concentrated—that is, *un*equally distributed—power. Social equality with regard to the distribution of wealth can be accomplished by means of organization only on the condition of sharp inequality with regard to the distribution of power. So if we define the condition of social justice broadly as a state of affairs in which both wealth and power are distributed in a roughly equal way, the suggestion that social justice could be realized by means of an organization in Hayek's sense seems self-refuting.

However, it does not follow from this line of reasoning that we should give up on the idea of social justice as a "mirage," as Hayek would have us do. The fact that socialists have tried and failed to achieve social justice by deliberately designing organizations devoted to that purpose is no more a reason to abandon the idea of social justice than the fact that mercantilists once tried and failed to enhance the generation of wealth by similar means was a reason to abandon the goal of enhancing the production of wealth. Neither of these goals seems amenable to a direct approach.

This should not seem particularly odd. Many individual and collective ends are amenable to attainment through indirect methods.

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For example, at the individual level, it is commonly understood that the aims of falling asleep and attaining happiness are best approached by indirect means and that efforts to attain these ends directly are likely to be self-defeating. People cannot generally fall asleep by focusing on the desired state of sleepfulness; they are usually better advised to do something to distract themselves from that goal and other cares, such as reading a relaxing book. Similarly, as philosophers from at least Aristotle onward observed, people do not attain happiness by concentrating on its attainment. Happiness is generally a byproduct of one's engagement in activities that have a different purpose. It should not be too surprising, then, that collective goals such as the generation of wealth and the attainment of substantive equality are best pursued by indirect means. Hayek's greatest contribution to twentieth-century social theory was his emphatic and consistent insistence, following Smith, that organization is not the only means, and often not the best means, of achieving social goals such as the generation of great wealth. Perhaps his greatest shortcoming was his failure to see that this observation could be applied to the goal of social equality as well.

Spontaneous Orders and Their Coercive Consequences

The comparative element in political and social criticism determines the power of that criticism. An attack on the principle of laissez faire can be powerful only if the advantages of a feasible alternative to that principle outweigh any disadvantages that alternative might have. Criticism is pointless unless there is a relatively attractive alternative to the object of criticism.

Hayek implicitly recognizes the comparative dimension of political criticism, for his attack on the ideal of substantive equality goes hand in hand with his defense of the market order. As we have seen, Hayek's principal criticism of the ideal of substantive equality is that that ideal undermines the rule of law and, with it, the liberty of individuals to pursue their own ends as they see fit. In his view, to attain the ideal of substantive equality, a society would have to take on the features of an organization and to shed those of a spontaneous order. In the previous section, I argued that this assumption is incorrect. The ideal of social justice aims at a determinate outcome. But one of Hayek's principal arguments in favor of the mar-

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ket order is contingent on the claim that *that* order produces a determinate outcome. There is no necessary reason to suppose that the first of these stipulated outcomes is more likely than the second to require the organizational type of social order.

The question to which I now turn is: How successfully does the market order protect the liberty of individuals to pursue their own ends as they see fit? The question is relevant to Hayek's attack on the ideal of social justice because the market order is Hayek's alternative to a social order that would aim at the attainment of social justice. Is the market order as effective a protector of liberty as Hayek claims?

Hayek himself makes much of the differences between his own conception of liberty and the conception to which he believes socialists typically adhere. According to Hayek, who claims to be following in a tradition of thought that extends from the ancient Greeks and Cicero down to Locke, Hume, and Kant, law and liberty are inseparable (Hayek 1973, 51–52). Man is free if he can pursue his own ends as he sees fit within the law without the imposition of anyone else's arbitrary will upon him. By contrast, in the characteristic socialist conception, freedom becomes "merely another name for power or wealth" (Hayek 944, 26).[14]

Nonetheless, Hayek's defense of the market order rests almost as heavily on the claim that it empowers human beings by generating wealth as on the thesis that it protects liberty. Here is a typical statement:

> In civilized society it is indeed not so much the greater knowledge that the individual can acquire, as the greater benefits he receives from the knowledge possessed by others, which is the cause of his ability to pursue an infinitely wider range of ends than merely the satisfaction of his most pressing physical needs. (Hayek 1973, 14)

The reason individuals in civilized societies can pursue such a wide range of ends—and the reason that, according to Hayek, these societies are preferable to their less-developed forerunners—is that civilized societies generate vast amounts of wealth. A short name for the ability to pursue a wide range of ends is "power." So there is a good deal less at stake in the longstanding quarrel over how best to define "liberty" than is often alleged, at least for the purpose of assessing Hayek's theory.

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Still, for my purposes Hayek's conception of liberty is adequate. In the discussion that follows, then, by "liberty" I will mean an absence of coercion, where coercion is understood to consist of the arbitrary imposition of one human being's will upon another. How well does the market order protect liberty conceived in this way?

The answer, I am afraid, is: not very well. Hayek's own theory of social order provides some of the principal tools that point toward this conclusion. According to that theory, spontaneous orders are maintained by relations of mutual adjustment, give and take, and reciprocity. In contrast, organizations are maintained primarily by relations of command and obedience. The rules (if any) by which these relations of command and obedience are regulated are themselves legitimated instrumentally by reference to the goals of the organization and are consequently as plastic as the pursuit of those goals requires. So the primary relations on which organizations depend tend inherently to have at least a partially coercive character, even when that character is masked by widespread acceptance, routinization, and the like. Human beings are free (by Hayek's definition of freedom) to the extent that their relations are free of this coercive element.

As we have seen, Hayek describes the market order as a species of spontaneous order. This description is accurate as a characterization of the *theory* of the market order Hayek presents. It is also *partially* accurate as a characterization of market orders in practice. As a depiction of the character of market orders as a whole, however, Hayek's description is a serious distortion of reality.

As Hayek cheerfully acknowledges, the market order, and indeed any spontaneous order, presupposes organization. Spontaneous orders are dependent on the enforcement of a framework of rules of just conduct, and the task of enforcement requires an organization (a government). In the case of the market order, by Hayek's account, the essential, minimal[15] functions of government include the maintenance of security and the enforcement of laws of property and contract.[16] If these services were not performed, no spontaneous order, providing a context within which individuals can reasonably predict the consequences of their actions, could arise. So even though, in Hayek's view, the coordination of human actions is generally best accomplished by means of spontaneous orders, some element of organization is also required to achieve coordination.

Hayek is probably right to claim that the market order, and per-

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haps any spontaneous order, *presupposes* organization. But he fails to grasp the extent to which the market order tends inherently to *generate* organization. This tendency has at least two sources. First, in a competitive market environment, human beings tend to combine forces in order to improve their competitive positions and reduce uncertainty. The primary results of this tendency toward combination are business enterprises and labor organizations. Second, because market transactions entail pervasive externalities, these transactions cumulatively tend to stimulate demand for organizations to correct or compensate for those externalities.

Hayek was well aware of the existence in modern societies of groups organized around common economic interests. In fact he took critical aim at these groups in *The Road to Serfdom* and continued his assault on organized economic interests, especially labor unions, throughout his life. Hayek was a biting and dogged critic of the idea of collectivist or "organized capitalism" (1979, 92):

> It is a wholly mistaken conception that a bargaining between groups in which the producers and the consumers of each of the different commodities or services respectively are combined would lead to a state of affairs which secures either efficiency in production or a kind of distribution which from any point of view would appear to be just. . . . [Such a scheme] would in fact produce a structure which would be demonstrably irrational and inefficient, and unjust to the extreme in the light of any test of justice which requires a treatment of all according to the same rules.

According to Hayek, the tendency of economies to be dominated by bargaining among organized groups distorts the distribution of benefits so that that distribution is neither efficient nor fair. This conclusion is pithily summarized in his statement that "the collective actions of organized groups are almost invariably contrary to the general interest" (Hayek 1976, 138).[17]

Hayek was far from blind, then, to the existence of organized economic interests. Nevertheless, he failed to see how "spontaneous" the tendency for these interests to assume collective and organized forms really is. As a general rule, people's interest in security takes priority over their other interests. If people can enhance their security by combining forces with others, they will do so, usually without much regard for the consequences of their combinations for third parties. Just as people will combine politically and

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militarily to preserve their physical security, leaving those who are excluded from the combination to fend for themselves, they will combine to maintain their economic security with little consideration for the effect of their common actions on others.

Hayek portrays the tendency of human beings to band together into groups for the purpose of collective action as a relic of primitive societies that is out of place in, and at odds with, the spontaneous orders that constitute modern liberal societies. But the truth is that this tendency is inherent in the market order itself. For as Hayek frequently emphasizes, the market order generates a great deal of economic uncertainty. That uncertainty is in tension with the fundamental human interest in security. The tendency toward collectivization and organization is a consequence of this tension.

In the nineteenth and twentieth centuries—the period in which the market order arose and evolved—this tendency has been so striking that it has led to the transformation of one of the central presuppositions of political philosophy. Political philosophers from Plato and St. Augustine to Machiavelli and Hobbes tended to assume that in the absence of calculated and deliberate human intervention, social life would tend to drift toward anarchy. The condition of anarchy was seen as the natural starting point, and for many writers the natural ending point, of the evolution of human institutions; any non-anarchical form of human society, it was assumed, could arise only as a product of conscious human activity designed to bring that form of society into being. In modern political philosophy this presupposition has been virtually reversed. To many modern writers, the "natural" drift of human affairs has seemed to be not toward anarchy, but toward organization of increasingly stultifying kinds. The outstanding statement of this perception is the work of Max Weber, whose prediction about the "iron cage" toward which he believed modern societies were evolving still captures one of the principal anxieties of modern social observers (Weber 1958).

The market order also generates organization as a means of compensating for market failures. These failures take two forms: failures of markets to provide goods in which many people have an interest but for which no one wants to pay, and failures to prevent the imposition of harmful effects, such as pollution. Usually these failures are redressed by governments through the provision of services or through regulation—that is to say, through organizations devoted to

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the accomplishment of specific ends. Hayek acknowledges the need for some government services beyond those required to establish rules of just conduct and to prevent violence, theft, and fraud. But he appears to underestimate the consequences for social order of the need for these services, and he fails to see that the extent of the need for organizations to redress market failures is related directly to the extent and vigor of the market order.

The fundamental claim lying behind Hayek's attack on the ideal of substantive equality is that any feasible order in which that ideal could be realized or approximated would fail to provide the kind of strong protection for liberty (defined as the absence of coercion) that is guaranteed by the market order. But the tendency of the market order to generate organizations that maintain coordination by means of relations of command and obedience undermines Hayek's depiction of that order as the guarantor of liberty. The market may in theory be a spontaneous order based on relations of mutual adjustment, give and take, and reciprocity, with no centralized authority and no systematic hierarchy characteristic of the entire order. But if in reality that order tends systematically to generate in reaction to its deficiencies organizations that are structured hierarchically by relations of command and obedience, it may fail to provide the high degree of protection for liberty Hayek claims for it.

It might be argued that an economic order that has come to be dominated by organized groups is no longer a market order at all in Hayek's sense of the term. This argument is correct, but it suggests that a market order in Hayek's sense of the term either is not a feasible alternative at all, at least on a sustained basis, or does not have the liberty-protecting consequences he claims for it.

Hence Hayek's attack on equality fails on the two major fronts on which it would have to succeed in order to be persuasive. Hayek claims that the ideal of social justice entails substituting organization for spontaneous order so as to secure the goal of substantive equality. This substitution would result in a diminution of liberty. But Hayek fails to demonstrate that the goal of substantive equality is more likely to be damaging to the prospects of liberty than the goal of maximizing the generation of wealth, which he endorses. So Hayek's negative argument against the ideal of social justice collapses. Hayek's positive argument in favor of the market order—the alternative for which he claims superiority over any feasible order

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that might realize the goal of social justice—falls short as well. For he fails to see that the tendency of the market order to generate organization and thereby to threaten liberty is inherent in that order itself.

Insofar as Hayek's attack on the goal of social justice is rooted in his defense of the value of liberty, that attack should be reconstructed as an attack on a *particular strategy* for attaining social justice, namely by means of its direct imposition as a matter of state policy. In the end, this strategy is bound to be self-defeating, at least if the condition of social justice is defined as one in which individuals enjoy some rough equality of power as well as wealth. If the strategy of direct imposition is inadequate, however, it does not follow that the goal of substantive equality itself should be abandoned. Like many other desirable states of affairs, substantive equality is probably best approached by what I have called strategies of indirection, strategies that employ indirect means to attain a goal that probably cannot be reached by the most direct approaches.

Of course, nothing I have said in this essay proves that the goal of social justice is attainable. We do not know whether strategies of indirection can generate egalitarian results with the same effectiveness with which the market order apparently generates wealth. If no plausible strategies can be discovered, then the goal of social justice will prove to be a mirage after all. Yet on the other hand, Hayek offers us no reason to assume that the search for such strategies is likely to prove futile. Hayek's own conclusion that the goal of social justice is a mirage is premature, at best.

It may turn out that the position occupied by the goal of social justice today is roughly comparable to that occupied by the goal of wealth generation in the years preceding the publication of Adam Smith's *Wealth of Nations*. At that time, social theorists and policy makers had developed a strong interest in the generation of wealth. Yet their success in attaining this end was spotty at best, and their understanding of how to proceed toward it was limited. This description aptly characterizes the state of the ideal of social justice as a matter of both theory and policy today. If this judgment is correct, then it may be more appropriate for us to rethink the strategies by which the goal of social justice has been pursued in the past than to abandon that goal.

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NOTES

1. "Probably nothing has done so much harm to the liberal cause as the wooden insistence of some liberals on certain rough rules of thumb, above all the principle of laissez faire" (Hayek 1944, 17).
2. "There is no reason why in a society which has reached the general level of wealth which ours has attained the first kind of security should not be guaranteed to all without endangering general freedom. . . . There can be no doubt that some minimum of food, shelter, and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody" (Hayek 1944, 120).
3. Hayek lays out his theory of the two types of order succinctly in Hayek 1973, ch. 2. The theory is developed and embellished throughout the three volumes of *Law, Legistration and Liberty*.
4. For the theme of disagreement about ends, see Hayek 1944, 57–59; 1976, 3, 109–111; 1979, 24.
5. John Rawls calls the notion of justice Hayek has in mind "pure procedural justice." See Rawls 1971, 86.
6. For this theme, see Hayek 1976, 109–111.
7. "With the world as it is, with everyone convinced that the material conditions here or there must be improved, our only chance of building a decent world is that we can continue to improve the general level of wealth" (Hayek 1944, 210). See also Hayek 1973, 103 and Hayek 1976, 70ff.
8. "This division of labor, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion" (Adam Smith [1776] 1937, 13).
9. The direct reference of the comments quoted here is to the practice of planning in general rather than to the goal of social justice in particular.
10. Hayek's argument about this point bears a close resemblance to Robert Nozick's (1974, 153–66) criticism of the idea of a patterned end-state conception of distributive justice.
11. These two alternatives do not exhaust the possibilities, of course, and it seems likely that another alternative would be preferable to both. The best-known alternative to them nowadays is John Rawls's (1971, 1993) difference principle. According to this principle, when we are faced with a choice among alternative social orders, we should select the alternative that leaves the least advantaged members of society better off than any of the other alternatives would do, as long as certain other conditions are met (most notably, the condition that certain basic rights and liberties should be guaranteed equally for all).
12. In the preface to the original edition of *The Road to Serfdom* (1944, xvii), Hayek writes that "all I shall have to say derives from certain ultimate values," about which he appears to assume that his readers will agree. Hayek does not explain why he expects people to agree about ultimate values de-

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spite the fact that (as he repeatedly observes) they disagree fundamentally about ends.

13. A close look at some of the language in which Hayek first argued his case against the ideal of substantive equality is revealing:

> A necessary, and only apparently paradoxical, result of this is that formal equality before the law is in conflict, and in fact incompatible, with *any activity of the government* deliberately aiming at material or substantive equality of different people, and that *any policy aiming directly* at a substantive ideal of distributive justice must lead to the destruction of the Rule of Law. (1944, 79, emph. added).

As this language shows, Hayek aimed his criticism carefully at direct governmental action. Unfortunately, he never considered any other possible means of pursuing the end of social justice, and his later attacks on that ideal became less carefully targeted than this initial attack.

14. Hayek's attack on the alleged conflation by socialists of the concepts of liberty and power was echoed and amplified by Sir Isaiah Berlin ([1958] 1969).
15. Of course, Hayek never denied that governments can and should provide services that go well beyond these minimal functions, including the provision of welfare services. For one statement, see n2 above.
16. Ironically, the institution of universal freehold property, which Hayek rightly regards as fundamental to the market order, is itself a product of the very "constructive rationalism" he attacks as a threat to liberty in Hayek 1973. For a recent historical study, see Kaim and Baigent 1992.
17. In this as in many of his other claims, Hayek echoes Adam Smith. Curiously, however, Hayek tends to exempt the modern business corporation from his condemnation of combinatory and collectivist practices by arguing that corporations possess power primarily over material things rather than men (see the argument that begins at Hayek 1979, 80). In contrast to this view, Smith held that the tendency of employers to combine and conspire posed considerably greater dangers than any corresponding tendency among other economic groups. In part this judgment reflected the fact that laws at the time prevented workers from combining effectively, whereas they permitted combinations among employers. It also reflected Smith's view that the interests of employers as a group, unlike those of landowners and laborers, are systematically at odds with the common interest. For the most relevant passages, see Smith [1776] 1937, 66–67, 128, 248–50.

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Juliet Williams

ON THE ROAD AGAIN: HAYEK AND THE RULE OF LAW

ABSTRACT: *In his political writings, F. A. Hayek faces a classic liberal dilemma: he opposes coercion but recognizes that sometimes the state can help to minimize it. Hayek attempts to resolve the dilemma of the limits of state power by offering a definition of the rule of law that does not depend on a controversial conception of rights. However, his effort to formalize the rule of law fails. Not only does Hayek implicitly rely on an undefended theory of rights, but his rule-of-law scheme is limited to the elaboration of general principles of good government, neglecting the need for reforms aimed directly at the political processes that result in the controversial forms of coercion he deplores.*

Liberal political theorists court paradox when they argue that the state is both a necessary guarantor of individual liberty and also liberty's gravest threat. While liberals uniformly despise tyranny and fear state power, few are antistatist. Many are enticed by the ideal of a stateless society, but most agree that in practice it would deliver less liberty than would a limited state. Liberals typically downplay their ambivalence toward the state by playing up their antipathy to unjustified coercion, although it cannot escape notice that even the most energetic appeal to limit the state may presuppose its neces-

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sity. Self-proclaimed classical liberals deny the rich and varied tradition of liberalism when they reduce it to antistatism, or the popular dictum that the government which governs least, governs best.

Classical liberals are not alone. The complexity of the liberal attitude toward the state has been widely ignored, leaving intact the longstanding but undeserved reputation of philosophical liberalism as "ardently antistatist" (Holmes, 1995, 21). Curiously, this reputation has survived despite the emergence of an unapologetic statist like John Rawls as the premier twentieth-century liberal. Academics now cling to an image of liberalism that is dangerously close to obsolescence in a world in which the "L-word" is more strongly associated with Michael Dukakis than Adam Smith.

The scholarly reception of the work of F. A. Hayek vividly reflects the obstinacy with which most commentators cleave to the image of liberalism as antistatist. Hayek is popularly known as a libertarian fundamentalist, and he serves as something of a hero in contemporary libertarian circles.[1] Given the virulent antisocialism of *The Road to Serfdom*, Hayek's reputation as an antagonist of the modern welfare state is understandable. However, this image of Hayek poorly captures the attitude towards government that actually appears in his writing. Hayek's critique of socialism should not be taken as a wholesale rejection of the modern state. In his later writings especially, Hayek argues that a limited state is both possible and desirable, provided that the rule of law is firmly respected as its governing ethos. Rather than oppose the state as a matter of principle, Hayek aims to show that when its legislature is properly constrained, government need not be feared.

In so doing, Hayek makes a good-faith effort to engage the dilemma familiar to all liberal institutional architects, namely, that the state which is powerful enough to protect its citizenry from encroachments on individual liberty may be too powerful to control itself.[2] Hayek strives to advance the liberal cause by developing a model of limited government that grants individual freedom strong protection. But as Stephen Holmes points out, the mere fact that a government is limited means neither that it is minimal nor that individual liberties are adequately protected. Holmes points to a further complication in limiting government when he suggests that an important lesson to be learned from the collapse of the Soviet Union is that limited government, of the form familiar in Western capitalist democracies, "is, or can be, more powerful than unlimited

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government" (1995, xi). Closer to home, a final lesson may be gleaned from the history of liberal constitutionalism, which demonstrates that limits simultaneously constrain and enable government. The U.S. Constitution seriously limits state power, but it also creates and legitimizes the power government does have. Limits are necessary, but hardly sufficient, to make a state truly liberal. From the standpoint of liberalism, the question is not just whether the state is limited, but where those limits lie.

As Hayek was well aware, the familiar assumption that liberalism entails limited government offers only limited practical guidance concerning how to make it so. Despite the complexities that the question of limited government poses for liberals, it is surprising that the liberal theory of institutions has mostly stayed the same. For centuries, liberals have endorsed a slew of by-now familiar proposals for institutionalizing limited government: the separation of powers, constitutionalism, bicameralism, representation, and majority rule. Liberals also typically value the rule of law, the notion that government should be constrained by the same laws that bind the citizenry.[3] However, in light of the massive changes in the form and function of the modern welfare state, the appropriateness and sufficiency of the traditional institutions of limited government must be reassessed. With the notable exception of Hayek, twentieth-century liberal theorists have for the most part neglected the complexity of questions of institutional design.[4] The general tendency has been to assume that once the normative foundations of a liberal society are established, institutional design becomes a merely technical matter.[5] Hayek deserves credit as one of the few twentieth-century liberals seriously to question the compatibility of old versions of liberal institutionalism with the new reality of the advanced welfare state. By attempting to work through the contradictions of liberal democratic politics, Hayek keeps the conversation of liberalism not simply alive, but vigorous and, at times, even urgent.

Nonetheless, Hayek's institutional proposals are fatally flawed because he does not develop a coherent position on the nature and purpose of legislative politics in a liberal regime. Hayek's insistence that the legislative power be sharply constrained ultimately is undermined by his commitment to neutrality. Rather than dictating a total solution to the problem of the ideal relationship between the government and its citizens, Hayek acknowledges that in a truly liberal regime the details must be left open to debate; there can be

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no simple liberal answer to the question of how much government is too much. For this reason, Hayek opts for a formal theory of the rule of law, rather than specifying clear and final boundaries of state power. In brief, Hayek's antigovernment rhetoric is difficult to square with his concession of the need for legislative politics.

Ever since the publication of the articles reprinted in his *Collectivist Economic Planning* (1935), Hayek has been known as a merciless foe of socialism, but his underlying critique of legislative politics and its consequences for limited government is less familiar. The radical suggestion appearing both explicitly and tacitly in Hayek's writing is that the legislature as we know it has been at best a noble failure, a several-centuries-long experiment whose costs now clearly exceed its benefits. Hayek associates the welfare state and the attendant burst in legislative initiatives with totalitarianism. He thereby dismisses such likely ideological candidates as nationalism and racism, or underlying circumstances such as need or inequality, as the roots of twentieth-century political pathology. Instead, he attributes modern political woes to redistributive legislation. "So long as it is legitimate for government to use force to effect a redistribution of material benefits—and this is the heart of socialism—there can be no curb on the rapacious instincts of all groups who want more for themselves" (1979, 150). For Hayek, redistributive politics threaten to unravel the uneasy settlement of liberal society.

In time, Hayek's critique of redistributive politics swelled into a critique of politics altogether. He ultimately proposed nothing less than "the dethronement of politics" (1979, 128-52). Hayek concluded his last great political work with a grim observation:

> It can scarcely be doubted that quite generally politics has become much too important, much too costly and harmful, absorbing much too much mental energy and material resources, and that at the same time it is losing more and more the respect and sympathetic support of the public at large who have come to regard it increasingly as a necessary but incurable evil that must be borne. (1979, 149)

Hayek therefore proposes to limit politics as much as government. Contempt for politics is nothing new, especially for liberals who characteristically juxtapose the dirty politics of legislation to the sacred discourse of law.[6] Indeed, Hayek uses the rule of law as the rationale for a series of novel suggestions for curtailing the scope and

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the consequences of legislative power. Hayek's prescriptions founder, however, because they misunderstand the nature of liberal politics. First, Hayek's theory of political freedom is indeterminate on the question of politics altogether—that is, he offers no principled reason to prefer democracy over other political forms. Second, the rule-of-law ideal he advances is inadequate as a means of limiting government. Finally, Hayek's rule-of-law ideal neglects a wide range of problems characteristic of the modern political experience. Thus, while Hayek's intent is to develop a theory of limited government, his argument provides a surprisingly weak basis for it.

It is worth pausing to comment on what I take to be at stake in assessing a thinker whose position in the canon of liberal thought is, at best, precarious. Hayek has earned the dubious distinction of being the kind of liberal that no liberal likes. Redistributive liberals typically dismiss him as a libertarian extremist, while committed libertarians have been highly critical of Hayek's support for such statist policies as taxes and conscription (e.g., Hamowy 1982, Kukathas 1990). It seems to me that Hayek's ambivalent liberalism is especially interesting, however, precisely because it is caught between dueling liberal camps. Hayek grapples as few liberals have with the question of how to strike the ideal balance between popular sovereignty and constitutional limits in a liberal regime. He makes a valuable contribution by urging liberals to contemplate the institutional ramifications of liberal assumptions, rather than evading the tension by avoiding the practical dimension of liberal political theory.

Hayek and Democracy

Hayek's famous definition of the rule of law emerges as an answer to the problem of state coercion. If the essence of coercion is subjection to the will of another, how do we constrain laws to ensure that they do not enforce the will of some over all? Hayek's proposed solution lies in a set of formal requirements which together comprise his rule-of-law ideal. His central proposition is that to be legitimate, a law must be framed as a "general, abstract [rule], equally applicable to all" (1961, 154). Laws may never name specific individuals or classes. Government should establish with clarity and precision the rules of the game, but not require any particular

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moves within it. As Hayek explains in *The Road to Serfdom*, "government confines itself to fixing rules determining the conditions under which the available resources may be used, leaving to the individuals the decision for what ends they are to be used" (73).

The rule of law is intended to impose a "limitation on the powers of all government, including the powers of the legislature" (1961, 205). Perhaps because Hayek is so strongly associated with the project of limited government, it is often forgotten that he opposes *arbitrary* power, not governmental coercion generally. In *The Political Order of a Free People*, Hayek cautions against the impression

> that we regard the enforcement of the law and the defense against external enemies as the only legitimate functions of government. . . . Far from advocating such a "minimal state," we find it unquestionable that in an advanced society government ought to use its power of raising funds by taxation to provide a number of services which for various reasons cannot be provided, or cannot be provided adequately, by the market. (Hayek 1979, 41)

Hayek goes on to endorse state provision of roads (1979, 44) and publicly financed education (ibid., 61), as well as

> building regulations, pure food laws, the certification of certain professions, the restrictions on the sale of certain dangerous goods (such as arms, explosives, poisons and drugs), as well as some safety and health regulations for the processes of production and the provision of such public institutions as theatres, sports grounds, etc. (Ibid., 62)[7]

From these passages, it is hardly obvious how or where Hayek draws the line between legitimate and arbitrary rule. That is, just what is the extent of the coercive power of the liberal state? The confusion may result from the fact that Hayek is primarily concerned with the nature of constraint, not its extent. Hayek encapsulates his theory this way, in a well-known passage from *The Constitution of Liberty*: "The conception of freedom under the law . . . rests on the contention that when we obey laws, in the sense of general abstract rules laid down irrespective of their application to us, we are not subject to another man's will and are therefore free" (153). For Hayek, freedom is in principle entirely compatible with obedience to statist law. Arbitrariness as a feature of laws is independent of their democratic pedigree; it characterizes any "action

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determined by a particular will unrestrained by a general rule—irrespective of whether this will is the will of one or a majority" (1979, 8). Hayek's liberalism is motivated by a contempt not for government as a general constraint on individual liberty, but, rather, for the relationship of submission that structures of power make possible.

Hayek's version of the rule of law stresses legal form over democratic origin in order to supplant the idea that any law that emanates from a popular legislature is inherently just (1979, 1-19). He rejects liberal consent theory and other "constructivist" approaches that endow with legitimacy any action taken by a putatively democratic government. An apparent consequence of Hayek's rejection of these theories is to sever the familiar connection between liberalism and democracy. While historically liberals have raised grave concerns about the potential for incursions against individual liberty posed by popular sovereignty, most have argued that democratic decision-making is essential in a liberal state that values autonomy. However, Hayek's conception of arbitrariness provides no reason to prefer a law made by a democratic polity to a law handed down from above; the key is that the law conform to the formal principles of the rule of law.

Hayek is wary of democracy on the same grounds that he fears socialism. In his view, both allow particular groups or individuals to capture the state. Hayek urges that "socialism as much as fascism or communism inevitably leads into the totalitarian state and the destruction of the democratic order," but he says the same of democracy, when it is left unchecked. Even though Hayek believes that popular sovereignty most often functions as a mere cloak for repressive majoritarian rule, he maintains a strong investment in the democratic ideal. Hayek is especially spirited in his defense of democracy against what he sees as a rising tide of conservatism, in which he identifies an elitist tendency (1960, 401). He asserts that democracy "is an ideal worth fighting for to the utmost, because it is our only protection (even if in its present form not a certain one) against tyranny" (1979, 5). However, he never backs away from this fundamental qualification: "I do not regard majority rule as an end but merely as a means, or perhaps even as the least evil of those forms of government from which we have to choose" (1960, 403).

As Hayek sees it, "liberalism is a doctrine about what the law ought to be, democracy a doctrine about the manner of determin-

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ing what will be the law." For Hayek, this means that liberalism sets the limit on democracy, never the other way around (1960, 103). Richard Bellamy suggests a possible "paradox" for Hayek since "liberalism provides a philosophical basis for regarding democracy as the only valid source of law whilst apparently appealing to some higher law in order to limit democracy itself" (421). However, the real problem for Hayek is not that his commitment to liberalism conflicts with his desire to limit democracy, but rather that his version of central liberal principles does not entail democracy in the first place. In other words, Hayek eludes Bellamy's paradox by giving up the idea that the legislature should express the popular will. Before Hayek can address the relative priority of liberalism and democracy, he must first show that his liberalism does not thoroughly discount the latter. At the very least, the fact that Hayek's liberalism is so weakly tied to democracy suggests that his conception of political liberty is exceedingly narrow. Perhaps the best one can say is that Hayekian liberalism is neutral on the value of democracy; his conception of political freedom offers no principled reason either to reject or to embrace a democratic form of government.

Hayek hopes to placate committed democrats by showing that democracy does not need principled protection by liberal theory because in most cases it will be the most desirable, if imperfect, means of liberal political decision making. However, this assurance is belied by the fact that Hayek fears too much democracy more than too little (even though the road to serfdom is usually taken by those who dismiss democracy). Liberal theorists invariably choose between two roads to liberty. One stresses the value of self-rule and hence democratic governance; the other emphasizes limited government and hence the rule of law.[8] Hayek opts for limited government, arguing for what one commentator has described as "a machinery of state and a rationally constructed one at that—designed not to facilitate but to curb the consuming dynamism of democratic desire" (Levy 1989, 337). Hayek's willingness to use the "machinery of state" to quash overeager democrats is significant, given his failure to provide foundational support for maintaining democracy. As critics have been quick to comment, Hayek's rule-of-law regime is compatible with authoritarian modes of government.[9] Because his liberalism does not entail any particular theory of politics, such fears cannot be dismissed lightly; he offers no philosophical basis for choosing among widely divergent forms of rule.

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Minimizing Coercion

Recall that Hayek bases his rule-of-law ideal on the distinction between specifying the conditions of action and determining the content of action. Rules are legal; commands are coercive. As he explains in *The Road to Serfdom*, "it is the difference between laying down a Rule of the Road, as in the Highway Code, and ordering people where to go; or, better still, between providing signposts and commanding people which road to take" (74). Hayek argues that formal rules are the best way to insure a government that minimizes coercion. However, Hayek cannot stop there. After all, if this conception of the rule of law is based on a controversial theory of coercion, Hayek would have undercut the distinction between rules and commands, since the rule of law would enforce a particular point of view. So Hayek tries to give a definition of coercion that is uncontroversial. Does Hayek's effort to formalize the definition of coercion succeed?

In *The Constitution of Liberty*, Hayek rejects the notion that the "principle of non-interference" should be adopted as a definitive limit on state action. Instead, Hayek argues for a version of the rule of law that merely "enables us to distinguish between those measures which are and those which are not compatible with a free system," but then requires that legislative proposals be decided on a case-by-case basis "on the grounds of expediency" (222). Libertarian critics charge that this conception of the rule of law is useless in practice. The essence of the libertarians' argument is that too many laws fulfill the formal requirements of the rule of law—that is, they may be general, abstract, prospective, etc.—but nonetheless highly invasive of individual liberty. In short, a regime may satisfy the criteria of the rule of law and yet be illiberal. As Chandran Kukathas notes, "It is not clear that the abstract and general rules which conform to the ideal of the rule of law will always occur with principles which Hayek, and liberals generally, would find morally acceptable—unless those other principles are explicitly endorsed" (1990, 157-58). Ronald Hamowy goes even further, suggesting that Hayek's theory provides a justification for excessive coercion:

> Hayek's proposed framework . . . offers a rationale for what clearly are coercive acts of the state, e.g. conscription, interference in the economy (under the principle that it is attempting to minimize per-

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> sonal coercion) and alteration by fiat of the social structure of personal relationships which have developed spontaneously and undirected over the course of centuries. (1961, 31)

For the most part, Hayek was dismissive of claims such as these, accusing Hamowy in particular of doing little more than beheading the messenger. Hayek maintained that he was merely recognizing the "sad fact" that coercion is, for now, a necessary feature of social life. After all, he reasoned, if we can agree that the ultimate goal of politics is to attain a society as free of coercion as possible, then we must acknowledge that we can sometimes use coercion to combat greater coercion (1961, 28). Indeed, for Hayek the legitimate purpose of the legislature is to ensure that the "coercion of some by others is reduced as much as is possible in society" (1960, 1). As long as there is a potential for individuals to coerce each other, there is a potential role for the state to reduce this coercion.

Of course, the task of distinguishing legislation that reduces coercion from that which enables partial interests to use the state as an instrument of extortion may be difficult. Everything turns on what we deem coercion to be, and who "we" are. In *The Constitution of Liberty*, Hayek attempts to define coercion, although the discussion confuses as much as clarifies. The core idea is that "coercion occurs when one man's actions are made to serve another man's will, not for his own but for the other's purpose" (133). But what does it mean to "serve another man's will"? This question is particularly complicated in a market context, in which it is expected and approved that people act all the time based on external incentives. Indeed, market institutions, norms, and structures are intended to render obsolete the need to ask whether my actions serve myself or others; when incentives are well coordinated, the answer most often should be both. So the question for Hayek is how he intends to draw the distinction.

Hayek offers a surprising response to this question in the course of a broader defense of *The Constitution of Liberty*:

> The instance I discuss in my book is the situation in which somebody has acquired control of the whole water supply of an oasis and used this position to exact unusual performances from those whose life depends on access to that water. Other instances of the same kind would be the only doctor available to perform an urgent life-saving operation and similar cases of rescue in an emergency where

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> special unforseeable circumstances have placed into a single hand the power of rescue from grave danger. They are all instances where I should wish that those in whose hands the life of another is placed should be under a moral and legal obligation to render the help in their power even if they cannot expect any remuneration—though they should of course be entitled to normal remuneration if it is in the power of the rescued. *It is because these services are regarded as rights to be counted upon* that a refusal to render them except on unusual terms is justly regarded as a harmful alteration of the environment and therefore as coercion. (1961, 28–29, emphasis added)

And so a new Hayek is born! In a few short sentences, Hayek decisively distinguishes himself from all those who read his work as a basis for state minimalism. Clearly and resoundingly, Hayek argues that the purpose of rights is not just to specify what government cannot do, but also to create positive obligations that sometimes will entail substantial coercion of some citizens for the benefit of others.

The essential point is that the definition of rights determines what counts as coercion. From a political standpoint the question is, Who is to say what rights define the coercion the rule of law is designed to minimize? Is there a right to private property? To a minimum income? To health care? Hamowy is probably correct that a rule-of-law legislature would sometimes pass laws that violate his own libertarian sensibilities, but what is the alternative? The question is where to draw the line; there can be no question that it must be drawn somewhere. Hamowy might argue for a government that is constitutionally limited to the enforcement of private property rights, but Hayek does not see a way to justify this position to those whose understanding of coercion rests on a richer roster of rights or a different view of property. Hamowy fails to realize that there is no noncontroversial way to define coercion. It may be obvious to Hamowy that interference in a free-market economy is coercive, but this judgment presumes that a free-market economy is itself noncoercive—a claim that many socialists have challenged. While Hayek's discussion of the fictive oasis shows that he, like Hamowy, embraces a particular theory of rights, Hayek's intention is that the rule of law should *not* favor any one theory over another.

Apparently, the fact that controversy shrouds the question of the

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very nature of coercion drives Hayek to the conclusion that the scope of legislative politics is itself a political question, to be decided on the basis of practical, not philosophical, considerations. (This position is surprising in light of his persistent reminder that the legislative process too often deteriorates into an opportunity for officials, or groups with disproportionate influence, to impose their views on the citizenry as a whole.) Hayek is satisfied that government does not act arbitrarily, and thus minimizes coercion, when it restricts itself to general rules. He fears discretion, but he is loath to fix the limits of governmental power decisively. The genius of the rule of law appears to be that it empowers laws rather than persons to rule, by establishing strict constitutional limits on the reach of legislative politics. But this does not necessarily make legislative politics any less coercive, for constitutional limits may preclude legislation that would force Hayek's oasis owner to deliver necessary services.

While I agree with Hamowy and his fellow libertarians that Hayek does not succeed at his stated goal of curtailing arbitrary rule, I do not agree that the solution lies in even more rigorous standards to limit the legislature. When we limit a priori the possible range of legislation to almost none at all, we enforce a settlement based on a controversial decision about the definition of basic rights. Hamowy's brand of liberalism allows much less political play by establishing more constitutional limitations. But such a scheme exhibits precisely the sort of arbitrariness of which he accuses Hayek.

Hayek emerges from this bout with the libertarians in an awkward position. Either he must add more rigorous substantive criteria to his conception of the rule of law, or he must concede that the principle is vacuous. Hayek concedes that the "rule of law will be effective only in so far as the legislator feels bound by it" (1960, 205), but even when enforced, the rule of law tolerates such an expansive field of possible legislation as to contribute almost nothing toward the project of limited government. It is perhaps the struggle to resolve this dilemma that led Hayek to a closer study of the mediating role that could be played by institutions in a rule-of-law regime. While Hayek may have held his own in the rhetorical battle following *The Constitution of Liberty*, he ultimately conceded the war. In the end even he admitted that his moral appeal to the rule of law would never suffice to secure a liberal regime.

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Restraining the Legislature

Hayek's critique of democracy thus evolved into the direct assault on legislative politics presented in the *Law, Legislation, and Liberty* trilogy. Despite his fear of governmental excess, in *The Constitution of Liberty* Hayek betrayed a surprising degree of optimism concerning the legislature, arguing for its containment but not its displacement. It was only later, prompted by the critical insights of Bruno Leoni, that Hayek moved away from the *Rechtsstaat* ideal (Gray 1984, 69). This shift reflects more than the concession that a merely philosophical appeal for the rule of law is unlikely to lead to its instantiation. Over time, Hayek lost faith in the legislature as we know it. Eventually, he offered a more detailed, though oddly whimsical, model constitution, featuring key changes in the structure and balance of the central political institutions of the liberal state. There is, of course, an irony in Hayek's turn to the task of institutional design. Hayek is popularly known as the great enemy of the planned economy, and yet in the end he becomes a proponent of planned politics. As James Buchanan notes, Hayek gives no compelling reason why an evolutionary approach is superior to a rationalist one in the study of the market economy and social life more generally, but not when it comes to the political order.[10] Why should we deign to plan political institutions when we trust evolution to give us the best institutions in every other sphere of social life?[11]

Hayek is convinced that democratic rule tends inevitably toward particularistic, partisan government. He distills a series of harsh lessons from his historical survey of legislation, chief among them being that "the very omnipotence conferred on democratic representative assemblies exposes them to irresistible pressure to use their power for the benefit of special interests, a pressure a majority with unlimited powers cannot resist if it is to remain a majority" (1979, 128). Hayek continues to defend the democratic ideal against the degraded reality, but his ultimate rejection of the term *democracy* in favor of the ideal of "demarchy" testifies to the centrality of just such a strong legislature in most conceptions of democratic rule, and forces Hayek ultimately to abandon the concept altogether (1979, 38–40).

In *Law, Legislation, and Liberty*, Hayek offers a model constitution

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that includes a radical reconceptualization of the legislature. The most dramatic change is in the distribution of legislative power. Hayek's constitution "leaves the content of law to be developed by the legislature and judiciary" (1979, 124). Bellamy characterizes the new regime as a novel form of "tri-cameralism," which includes two governing assemblies and a Constitutional Court. The Legislative Assembly is charged solely with the determination of general rules of just conduct (Hayek 1979, 112-18). Hayek's rather unusual proposals for the election of members to these offices reflects his desire to shield legislators from the crude play of power politics. As Hayek explains, "it would seem wise to rely on the old experience that a man's contemporaries are his fairest judges and to ask each group of people of the same age once in their lives, say in the calendar year in which they reached the age of 45, to select from their midst representatives to serve for fifteen years" (ibid., 113). To further promote responsible decision making, members of each class would mix throughout their adult life in local clubs which, Hayek explains, "would possibly be more attractive if men of one age group were brought together with women two years or so younger" (1979, 117). While Hayek's ingenuity and commitment to a vitalized, participatory politics are admirable, his surprising attention to concerns like cohort compatibility seems more Orwellian than liberal.

Hayek's Governmental Assembly is charged with administering the general rules established by the Legislative Assembly. Hayek suggests that the former be modeled according to present-day parliaments; the difference in outcome would be an effect of its being limited by the upper house (Hayek 1979, 119-20). Finally, Hayek makes provision for a Constitutional Court to settle disagreements between the two assemblies and make changes in the constitution as deemed necessary (ibid., 120-22).

There is reason to be skeptical that such a scheme is capable of being actualized, given the obvious difficulties entailed in distinguishing general rule-making from administration and application. Hamowy contends that Hayek's proposal is politically naive, since "the effect of such a division of powers would be (and, indeed, was) to place in the hands of the lower house all substantive power to govern; for, while it could pick and choose which rules of conduct enacted by the upper house it wished to enforce, it could further enforce its own rules via the taxing power" (Hamowy 1982, 138).

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As with his more general theorizing about the rule of law, Hayek's institutional prescriptions seem likely to limit only those officials who would be inclined to obey its command anyway. Indeed, Hamowy suggests that Hayek's institutional changes are too trivial to constitute a real advance over the scheme he advocates in the *Constitution of Liberty*. Hayek shuffles power around, but he does nothing to contain it. Hamowy's indictment is unequivocal: "Despite his elaborate and complex schema of government, in the end Hayek returns to his original restrictions on the formal qualities of the rules of conduct that he first laid down in his *Constitution of Liberty* as the only protection against arbitrary government" (1982, 141).

I agree that Hayek's institutional proposals are inadequate, but I do not root this problem in Hayek's weak commitment to rights. As we have seen, Hayek has a less restrictive view of rights than Hamowy, albeit a much more restrictive view than some socialists and left-liberals, such as Rawls. Hamowy argues that Hayek's institutional vision is flawed because it is not intended to defend rights, properly understood. However, even if one shares Hayek's level of commitment to rights, his proposed institutions are incapable of protecting them. Hayek fundamentally misunderstands the political dynamics of the system he hopes to change. His failure to come up with his own non-arbitrary, formal redescription of the level of rights, obligations, and government he deems justified need not be interpreted, as Hamowy suggests, as evidence of the need for an absolute theory of governmental noninterference. Before reaching such a dire and, in my view, ultimately unnecessary conclusion, one must further consider the possibility that the project of limited government can be advanced by institutions designed to avoid the political pathologies that riddle the current regime. In other words, if Hayek's institutional theory were more reasonable, his moderation on the question of rights might not seem so threatening.

In *Law, Legislation, and Liberty*, Hayek spins an elaborate critique of legislative politics. He recounts the familiar charges of irresponsibility, inefficiency, and political favoritism. Hayek describes these problems mainly as unintended consequences of the current institutional order. His analysis of legislative politics seems to confirm his broader antirationalist orientation. Recall that Hayek pitches his case against socialism on largely epistemological grounds. It is the very nature of information, he argues, to be diffuse and unknow-

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able, and it is foolish to believe that any government is capable of knowing what it must to rule efficiently. Because of the problem of incomplete information, even legislatures that try to do the right thing cannot succeed. In his ideal constitution, accordingly, the Legislative Assembly is prohibited from making laws with the kind of targeted intentionality that is bound in practice to miss its mark.

While Hayek's argument has some merit in theory, it functions poorly as an explanation of current political failures. Rather than complaining of unintended consequences, many observers of American government, at least, have been compelled to focus on precisely the opposite problem, namely, that government is run by a group of skillful manipulators who are all too able to commandeer the legislature to serve their particular ends. Many of the procedural problems that facilitate these machinations, from logrolling to gridlock, are in fact exactly the results that the constitutional planners sought. Scholars are even beginning to acknowledge that bureaucratic discretion is a function not so much of vague or inept lawmaking as skillful legislative manipulation.[12]

What is to prevent common-law judges from behaving the way the much reviled technocrats do in the present scheme? Why should we not expect interest groups to penetrate the world of the laws and courts, just as they have the putatively neutral administrative arena? Hayek's insistence that we flee legislative politics leaves him ill-equipped to respond when politics creates problems in a new setting.

Deep in *The Constitution of Liberty*, Hayek offers an uncharacteristically personal glimpse into his outlook, foreshadowing his eventual turn against legislative politics. He asserts that

> the greatest threats to human freedom probably still lie in the future. The day may not be far off when authority, by adding appropriate drugs to our water supply or by some other similar device, will be able to elate or depress, stimulate or paralyze, the minds of whole populations for its own purposes. (1960, 216)

As strange as this scenario may seem, it is stranger still that Hayek thinks the rule of law could be an effective device in its prevention. It seems highly unlikely that menacing bureaucrats intent on such chicanery would be deterred by the fact that such an end could not be achieved by legal means. Hayek's rule-of-law regime offers sur-

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prisingly little by way of institutionalized impediments to governmental excess. Hayek intends to establish a rule of law, not men, but the theory is ultimately pitched as an appeal to conscience rather than a serious institutional proposal. This great proponent of the rule of law inadvertently shows that the fate of the limited government ultimately lies in the hands of persons, not laws.

The Future of the Rule of Law

At the outset, I posed a dilemma: is it possible for the liberal to reconcile support for statist government with an acknowledgment of the threats the state may pose to individual liberty? Hayek attempts to resolve this quandary by resort to the principle of the rule of law. His intention is to design a government that protects individual liberty without encroaching upon it. To this end, Hayek resists the libertarian urge to fix the limits of political power decisively, insisting that specific questions concerning the extent of state power be settled by a legislative process strictly bound by the rule of law. However, Hayek fails to resolve the problem of the precise role the legislature plays in a liberal regime: his polemic is one that disparages legislative politics, but his philosophy builds an important place for the legislature.

Hayek's struggle to resolve his ambivalence regarding legislative politics is instructive for liberals today. Any review of what's hot in contemporary liberal political thought quickly reveals that the subject of limited government generally, and legislative politics in particular, is not. But Hayek reminds us just how ambivalent liberals remain regarding the fundamental question of the limits of state power. My argument that liberals should turn their sights to this subject does not rest on the claim, fashionable today, that politics is an inherently noble or worthy undertaking. Rather, I have sought to show that liberals simply cannot afford to do otherwise.

NOTES

1. In what follows, I use the term "libertarian" to distinguish that class of liberals who defend the minimalist state by privileging the need to avert state tyranny, particularly as it manifests itself in control of the market.

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2. James Madison presents the classic formulation of this problem in Federalist 51:

> If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.

3. See Dicey 1982 and Fuller 1964.
4. Joshua Cohen and Joel Rogers note that in the avalanche of commentary following Rawls's *A Theory of Justice*,

> much less attention has been devoted to examining the political institutions and social arrangements that might plausibly implement reasonable political principles. Moreover, the amount of attention paid to issues of organizational and institutional implementation has varied sharply across the different species of normative theory. Neoliberal theorists, concerned chiefly with protecting liberty by taming power, and essentially hostile to the affirmative state, have been far more sensitive to such issues than egalitarian-democratic theorists, who simultaneously embrace classically liberal concerns with choice, egalitarian concerns with the distribution of resources, and a republican emphasis on the values of citizen participation and public debate. (282)

5. This tendency finds full expression in Rawls's *A Theory of Justice*. Despite his many claims that the book is dedicated to a study of the institutions of justice, Rawls focuses almost entirely on the foundational questions, all but ignoring issues of institutional design.
6. For an interesting discussion of this tendency, see Macedo 1989, 111–30.
7. As far back as 1945, during an interview with two unapologetically hostile interlocutors, Hayek stressed his support for a minimum wage law and even a guaranteed minimum income (Kresge and Weiner 1994, 108–23).
8. This formulation is inspired by Lowi 1987.
9. See Flathman 1994 and Hamowy 1961.
10. Hayek's own skepticism regarding the power to plan politics is extreme. In *The Constitution of Liberty*, he denies credit to even the most successful constitutional planners history has yet known, those who authored the U.S. Constitution:

> Much is sometimes made of the fact that the American Constitution is the product of design and that, for the first time in modern history, a people deliberately constructed the kind of government under which they wished to live. . . . This attitude . . . was more justified here than in many similar instances, yet still essentially mistaken. It is remarkable how different from any clearly foreseen structure is the

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frame of government which ultimately emerged, how much of the outcome was due to historical accident or the application of inherited principles to a new situation. What new discoveries the federal Constitution contained either resulted from the application of traditional principles to particular problems or emerged as only dimly perceived consequences of general ideas. (183–84)

11. See the discussion of Buchanan's critique in Gray 1984, 70–71.
12. For a fascinating discussion of this dynamic see Schoenbrod 1993. Schoenbrod describes how again and again Congress shifts the blame for unpopular policies onto bureaucrats whom it accuses of having wrongly seized power. In reality, legislators often mask highly partisan laws behind vague statutory language, and then work behind the scenes to compel bureaucrats to execute their will.

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Gus diZerega

MARKET NON-NEUTRALITY: SYSTEMIC BIAS IN SPONTANEOUS ORDERS

ABSTRACT: *The market is sometimes thought to be a largely neutral means for coordinating cooperation among strangers under complex conditions because it is, as Hayek noted, a "spontaneous order." But in fact the market actively shapes the kinds of values it rewards, as do other spontaneous orders. Recognizing these biases allows us to see how such orders impinge on one another and on other communities basic to human life, sometimes negatively. In this way we may come to acknowledge the inevitability of placing limits on spontaneous orders.*

The modern world is uniquely characterized by the enormous rise in influence of the abstract and anonymous liberal community over all other communities, human and natural alike. As I use the term, "communities" are distinguished by the different relationships fundamental to each. The liberal community is rooted in market relations sustained and modified by democratic political intervention. Its standard of truth is found in science, the chief source of the technology most people use every day. In all three of these domains—the market, democracy, and science—the liberal community is characterized by the abstract procedural rules its members follow in pursuing their goals. These rules generate the market, democracy, and science by helping people who are largely unknown to each another to enter into extended cooperation for mutual benefit.

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The rules of the market, democracy, and science are abstract in applying to the generically human, divorced from all personal qualities. Their abstraction enables an indefinitely large number of people and projects to be integrated into complex and coherent patterns of cooperation, despite universal ignorance of the concrete conditions prevailing among those with whom one interacts in market, democratic, and scientific contexts. That they integrate the unpredictable plans of mutual strangers is the reason these three liberal orders are rightfully considered "self-organizing" or "spontaneous." Their order is very real, but unplanned.

Libertarians, and classical liberals in general, defend the market order as the most successful institution for facilitating creative and voluntary exchanges among equals. In addition, they tend to argue that because any given distribution of resources within the market is the unintended result of countless individuals making voluntary transactions with one another, whatever pattern of distribution arises is beyond fundamental criticism. In a spontaneous order, just means cannot generate unjust ends. Consequently, as Hayek (1976) has argued, "social justice" is a meaningless concept when applied to the spontaneous order of the market. This article offers a *Hayekian* challenge to this Hayekian line of thought. Two considerations weigh against these defenses of the market. First, the market is not the only spontaneous order generated by liberal principles of equality of status, abstract procedural rules, and voluntary transactions operating under conditions of complexity. Different procedural rules among equals promote different kinds of cooperation. For different rules promote different values, hence different spontaneous orders.

Second, the liberal community tends progressively to subordinate other communities to its standards, at the cost of narrowing the range of values that can be easily manifested. Even within the liberal community, its constitutive spontaneous orders tend to intrude on one another, distorting the values each exemplifies. Some values are unintentionally given precedence over others, even within systems of action where their dominance is unwelcome. Because these patterns of influence are forseeable, they raise questions of social justice not at the level of individual distribution, where Hayek's criticisms are valid, but at the systemic level, where they are not.[1]

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Varieties of Spontaneous Order

Self-organizing social systems economize on the knowledge people need to pursue their goals successfully. Science, the market, and democracy are so complex that no human being can grasp them except by using a theory divorced from concrete details (Hayek 1969, 22–42). Such a theory, however, can provide little or no guidance in making specific decisions within such an order. Few economists are successful entrepreneurs, few political scientists win public office, and few philosophers of science do valuable scientific research. The skills required to succeed within a spontaneous order are little connected to the skills needed to understand it.

As with all spontaneous social orders, the market promotes voluntary cooperation in pursuit of an indefinite number of independently chosen goals. The market is a discovery process encouraging people to cooperate in the pursuit of economic ends (Hayek 1978, 179–90). People acting within a framework of rules of private property, tort, and contract unintentionally generate an economic order; the wider the bundle of property rights, the wider the range of cooperative discovery that is made possible. The more secure the possession of such rights and the greater the certainty that agreements will be honored, the more exchange possibilities will be explored.

Similarly, procedural rules developed within the scientific community allow individual scientists' work to contribute to an unintentional overall order. Scientific rules, like those of the market, are applicable to all participants and are procedural in form, leaving to individual initiative how they are applied and leaving to the scientific community the outcome of their application. Again, cooperation in the pursuit of discovery is fostered, only in this case the goal is the discovery of scientifically verifiable truths (Polanyi 1969; Ziman 1968), not the discovery of efficient ways to satisfy economic demands.

In liberal democracy, freedom of speech and organization, and equality of the vote, generate a spontaneous political order. Like property rights, contract and tort law, and the principles of scientific method, democracy's rules are procedural and abstract. Freedom of speech and organization make it possible for the advocates of any cause to try to gain supporters. Equality of the vote ensures that successful political causes appeal to the perceived desires of

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more people than would be the case were votes not equally distributed. Liberal democracy encourages both the discovery of political goals and cooperation in their pursuit (diZerega 1989 and 1994).

The basic principle formally ordering human relations within all three of these spontaneous orders, which together make up the liberal community, is voluntary agreement among equals. The rules that generate the three spontaneous liberal orders require respect for individuals' autonomy. It is primarily in the context of individuals' agreements, in the number of people required for agreements to be productive, and in the nature of the issues over which agreement is sought, that the spontaneous orders of the market, democracy, and science differ from one another.[2]

The ethical principle underlying these liberal orders is largely isomorphic with Jürgen Habermas's analysis of the value underlying language (Habermas 1979, 1–68). Like the market, science, and democracy, language is self-organizing. Its order arises from each speaker appropriating common abstract rules of grammar so as to communicate, for whatever purpose she or he envisions. Moreover, in democracy, the market, and science, individual interaction proceeds largely through speech or written communication. In these respects they constitute contextually differentiated subsets of Habermas's more inclusive ideal speech community, and the values it exemplifies.

The only modification I would make to Habermas's basic argument is that his excessively egalitarian ideal of speech equality obscures the fact that knowledge is not and cannot be equally distributed. Knowledge as it exists in the scientific, market, and democratic orders must be discovered and tentatively validated through complex social processes. It is always incomplete and conjectural.[3] In other words, language is also a discovery process, facilitating our learning about one another, the world around us, and even ourselves. Under such circumstances equality of mutual influence is an absurd ethical ideal. A complex society where it could be attained is unimaginable.[4]

The market, democracy, and science all maintain an ongoing institutional openness to unpredictable initiatives by unknown others (Hayek 1978; Polanyi 1954; diZerega 1988, 1991). Because of our fragmentary knowledge of the plans of others, we experience these orders as *impersonal*. Hayek has discussed the positive dimension of the impersonality that characterizes relationships within the abstract

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liberal community of strangers. When fewer demands are made upon us in order to cooperate, we find cooperation easier. The range of viable human projects increases. On balance, we all benefit from this increase in cooperative opportunities. The evidence is readily apparent. The incidence of famine, disease, and poverty has been brought to the lowest levels in thousands of years due to the growth of spontaneous liberal orders. Less remarked upon, but equally important, their impersonality helps explain why liberal democracies do not make war upon one another. They are the first form of organized political life where this has been the case, and their peaceful record is intimately connected to their self-organizing character (diZerega 1995c).

However, there is more to human life than the liberal community of strangers; there are also families, face-to-face and reputational communities, and nature. Hayek himself was aware of some of these communities as necessary elements of any good society (Hayek 1976, 150–52). But I believe he underestimated the power of the liberal community to overwhelm them.

The Market as Non-Neutral

The market is the most fundamental spontaneous order in the liberal community. This is not only because we use material goods and human services in most or all of the communities in which we participate, but because the abundance and the characteristics of the goods and services available in the market powerfully influence the possibilities that can be pursued in the other spontaneous orders constituting the liberal community. Consequently, I will focus primarily upon the market order. However, broadly similar arguments can be developed for the social impact of science and liberal democracy.

The market is the most important facilitator of cooperation among producers of goods and services. These goods come from and often impinge upon the natural world, and also modify the broader social environment that sustains familial, face-to-face, and reputational communities. Libertarians and classical liberals are reluctant to criticize this feature of the market precisely because it is a spontaneous order. They tend to emphasize the fundamentally cooperative nature of the relationships that constitute the market

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order. Hence they view the market as essentially *neutral*. There is an important truth here. Critics of the market too rarely acknowledge its fundamentally cooperative character.[5] However, the classical liberal claim is overly broad, glossing over important circumstances in which it is not entirely true. The market would be perfectly neutral only for beings whose values and preferences were unaffected by the environment in which they live. Such beings would not be human.

It is difficult to imagine a truly neutral tool for facilitating human cooperation. All actual cooperation takes place within a particular institutional context, and this context influences what cooperative opportunities will emerge. As contexts differ, the rules most able to facilitate cooperation within them will also change. The point is as true for self-organizing systems as it is for instrumental organizations, although the ways in which it is manifested differ profoundly.

For example, the context of a work environment and the context of a romantic date generate different principles of cooperation because they are enmeshed in different community relationships. One is largely a means to other ends and is often impersonal; the other is usually considered an end in itself and is highly personal. Cooperation between friends will be facilitated by different rules than will cooperation between members of an organization who are otherwise unknown to one another. Even among strangers, the likelihood of cooperation will be influenced by whether additional encounters are likely (Axelrod 1984). At a minimum, these circumstances imply the existence of scale effects.

The market injects the bias of the contextual rules that characterize it into the community at large. Since these rules are impersonal, abstract, and formally voluntary, they can produce institutions as different as a supermarket or a crafts fair. In both cases people come together in order to make mutually satisfactory exchanges. In both cases money assists in making those exchanges. Assuming the parties involved act on adequate information, in both instances people will consider themselves better off after the exchanges than before them. But even in these two instances, we can begin to see a scale effect that ultimately turns out to be quite important.

Many, perhaps most, people who go to a crafts fair are attracted in part by the opportunity to interact with the creators of what they might purchase. They want their shopping experience to have

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a personal dimension. I have often sold art at such fairs. A frequent question I encounter is, "Did you make this?" By contrast, going to a supermarket focuses customers' attention on convenience and price. As the personal dimension fades, transactions become more impersonal and instrumental in character. In such cases one usually does not care who made something, for this knowledge adds nothing to its value. One only wants efficiency: the best quality at the least expense. (Think of shopping at Costco.) Catalogs and electronic shopping are perhaps the ultimate forms of impersonal markets, diminishing human contact to nearly zero.

From a libertarian or classical liberal perspective the success of Costco and other megastores simply represents a more efficient serving of consumer needs than did the more personalized forms of retail service they have replaced. Personalized service remains available in other stores, but customers now pay a premium for it. Costs are in better alignment with benefits. I believe this point of view is misleading.

The market order possesses a dynamic principle intrinsic to its spontaneous character. *Precisely because* it is not the outcome of deliberate decisions, it cannot simply be assumed to reflect people's desires faithfully. If we were to see the impact on others generated by the collective impact of our choices, we might make different choices. If the effect of collective choices is to select for some values and not others, we can legitimately ask whether the pattern of selection is fully desirable.

Systemic Resources and Value Biases

Every self-organizing social system depends for its success on both positive and negative feedback to those acting within it. This feedback takes the form of participants accruing or losing resources. What counts as a resource is defined by the system of cooperation. But what maybe highly valued systemically may not be so valued by the individuals acting within the system.[6]

In the market order, the basic systemic resource is money. As the universal means of market exchange, money is the glue that holds impersonal economic cooperation together. In the democratic order, the systemic resource is political support measured in votes. Votes ultimately determine who will succeed politically and who

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will not. Money is a very important, but still secondary, political influence (diZerega 1991). In the scientific order, money again plays an important but subordinate role. The amount of grant money a scientist brings in is supposed to be, at best, a proxy for the quality of his work. Indeed, the increasing focus upon obtaining grants may constitute a corruption of science by market values, akin to selling and buying votes in politics. For science to continue as a way of discovering how the world works, scientific reputation, not money, must be its most important systemic resource.

Because what counts as a resource is determined by the spontaneous order within which participants act, systemic resources may not necessarily be valued by the order's participants. I can participate in the market order without primarily seeking money, and be successful by my own standards. However, to the extent that I lose money, my ability to influence the market order fades. I have fewer systemic resources. The same point holds for the scientific and democratic orders. I need not be concerned with peer recognition as a scientist, or with getting votes as a politician, but without recognition or votes I lose the ability to influence these orders. I may be happy, and in my own eyes legitimately successful, but systemically I will be invisible.

To the extent that I seek to gain systemic resources, adopting them as my standard of success, I accept the values of the order in which I participate. But whether I will ultimately regard myself, or will be regarded by others, as a successful human being is quite another thing.

As a spontaneous order becomes more developed and all-inclusive, options to act will be greater for those possessing the most systemic resources. Viewed from within the order, this outcome appears as only natural. However, because resources are systemically defined, something that counts as a resource within one system may be systemically denied or devalued within another. There is a potential problem where systems border upon each other. This holds between the three spontaneous orders comprising the liberal community, and even more so between that community as a whole and the other basic communities within which we live.

Systemic boundaries are defined by networks of relationships structured by the rules and values that generate them. While the market, scientific, and democratic orders obviously influence one another, and while, to some degree, the resources of one can always

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be turned into resources for another, each can, when taken separately, be seen to comprise a coherent sub-community of the liberal community. Their interpenetration causes reductionists to seek some common principle, usually money, as their common foundation. But each system's ideal relationships are quite distinct from those of the others. When systemic resources from one system intrude on another, they are acknowledged as a potential threat to its integrity. Money is regarded as necessary in order to acquire material and personal resources, but when its availability determines how those resources will be used in the scientific or democratic order, money is perceived as corrupting. This is because judgments are then made according to "foreign" values, often by people who are not even members of the order in question. This problem is clearest in the scientific order. When science is not financially self-sustaining, research may follow financial rather than scientific judgment.

This problem is most complex in the democratic order because citizens are almost always simultaneously participants in the market order. Thus, they may try to turn the resources of one system into systemic resources in the other. Money can be used to influence political decisions, just as corrupt politicians may try to pass legislation to obtain money.

However, what is true of money in the scientific and democratic orders is equally true of scientific expertise in the economic and political orders. Scientific standards are biased in favor of measurement and prediction, but most political questions are also, or even mostly, imprecise or qualitative. And, as experience repeatedly demonstrates, voting is a poor way to make either scientific or economic decisions. Yet due to the interpenetrating character of these orders, each will always influence the others. It is often a judgment call whether influence in any particular instance is tolerable or excessive, because any standard will itself be biased in favor of one order or another.

The Market Place and the Market Order

Impersonality is a central but largely unintended outcome of acting within the context of a spontaneous order. As these orders tend to grow more encompassing, human relationships within them become increasingly characterized by their utility in acquiring sys-

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temic resources. In the market, growth is the result of successfully serving consumers. But growth itself influences the mix of services an enterprise offers, and it alters its owners' way of relating to their employees. In both cases impersonal relationships tend to replace personal ones.

As growth continues, the division of labor becomes increasingly elaborated. Most importantly for my purposes, the functions of ownership become divided. Different people begin to exercise separate dimensions of tasks once performed as a unity in the mind of a small proprietor. As the market becomes increasingly impersonal and anonymous, the market place is subsumed into the market order. [7]

Large corporations are a powerful institutional expression of market-order relations, as contrasted with relations in the market place. Within them, the functions of ownership are divided among many people often unknown to one another. In the market place, people encounter one another as owners of resources potentially available for exchange. In corporations, neither managers nor shareholders really act as owners in this sense. Neither managers nor shareholders have the scope of choice and responsibility that actual owners face in the market place.

Managers are under legal mandate to serve shareholders' financial interests. Among shareholders, the voting process is proportional to the number of shares owned, and therefore to the amount of money each shareholder has at stake. Within the market order there is nothing wrong with this. Most people only invest in corporations for financial reasons. So even if they own only a few shares, on balance they benefit from the weighting of influence in favor of financial values. Large shareholders provide oversight and expertise that ultimately assists even small shareholders, for the value of everyone's shares rises or falls in unison.

For shareholders, ownership almost never carries the ambiguities and conflicts that arise from exercising personal responsibility over tangible property in the market place. Personal values are subordinated to financial values because of the institutional framework in which people exercise their "ownership" rights. For example, the largest First Interstate Bank shareholders became angry when corporate managers considered the impact on the California economy of Wells Fargo Bank's proposed takeover of First Interstate. Yet in

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their personal relationships, it is common for owners to take account of such non-economic criteria in determining what to do.

Although the corporation is legally regarded as a human being, it possesses three relevant characteristics that no human being has. First, it is potentially immortal. Second, its physical assets can be either absorbed or broken apart into other companies without changing its productive activities. Third, and most significantly, the corporation is entirely a creature of the liberal community. Indeed, many economists criticize managers who act on the basis of values more appropriate to other communities. As Milton Friedman writes:

> Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. . . . If businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-selected private individuals decide what the social interest is? (Friedman 1963, 133–34)[8]

Friedman emphasizes that charitable giving by corporations "is an inappropriate use of corporate funds in a free enterprise society." Instead, "contributions should be made by the individuals who are the ultimate owners of property in our society." Allowing corporations to make tax-deductible charitable contributions "is a step in the direction of creating a true divorce between ownership and control and of undermining the basic nature and character of our society" (1963, 135–36).[9]

Friedman's point is not without weight. Yet in an important sense ownership has *already* been divorced from control simply by the creation of joint stock corporations. In addition to this shift of *control*, there has been a change in what it means to *own* something. Within the context of their daily lives, real people integrate the varying and conflicting demands and responsibilities arising from membership in all the basic communities in which they live. As citizens, for instance, they continually participate in deciding "what the social interest is." Corporations, to the extent they operate impersonally, are incapable of doing so. They are purely creatures of the market order, not the market place. Shareholders are owners from whom every characteristic has been abstracted except their financial interests.

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They invest for a return. Many shareholders regard financial return as only one value among many in their lives. They may treat the concrete things they own as if financial return is not the most important value. But financial return alone influences the actions of the organizations they "own" in their capacity as stockholders.

Investment fund managers, who may control enormous blocs of shares, carry this abstraction from personal ownership one step further. The investor in a mutual fund is further removed from the organizations in which he or she invests, and her ability to focus only on financial return is therefore made more efficient. This can be seen by contrasting normal investment funds against special "conscience" funds, such as those which invest only in "green" businesses. In these funds the abiding principle is "greenness"; financial considerations place (an important) second. However, that such rules have to be specially structured into the decision making of green mutual fund managers demonstrates how extraneous they are to the market order.

Mutual funds are the most complete expression of market-order relationships. Their investors are often completely unaware of the companies whose shares they "own." To equate such a relationship with the personal ownership of tangible property is to blur very important distinctions rooted in different kinds of systemic relationships—that is, different kinds of community. Friedman falsely equates the owners of impersonal shares with the owners of tangible property, over which they exercise direct control and have personal responsibility. These constitute fundamentally different kinds of ownership.

In the market order, as our decisions become increasingly impersonal, they become dominated by the requirements of efficiency. We will put up with a friend's inefficiencies when we would not tolerate similar failings by a stranger. As our relationships become impersonal, interpersonal transactions come increasingly to be pure means to other ends. What justifies such relationships is their anticipated end result, considered completely separately from the relationship itself. The relationship as such becomes a pure cost. As the market process develops and elaborates, personal choices become more and more constrained by one's ability to serve consumers per se rather than by one's ability to serve neighbors, friends, or even human beings per se.

This evolution is "spontaneous," in Hayek's sense. We never de-

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liberately choose a social order reflecting these values. This transition may seem innocuous because economists always speak of us as consumers, and because we are all consumers some of the time. But thinking of ourselves as consumers involves a subtle distortion of our understanding. All people are indeed consumers. But no one is *simply* a consumer.

The free-market economist Ludwig von Mises once described consumers as

> merciless bosses, full of whims and fancies, changeable and unpredictable. For them nothing counts other than their own satisfaction. They do not care a whit for past merit or vested interests. If something is offered to them that they like better, or that is cheaper, they desert their old purveyors. *In their capacity as buyers and consumers* they are hard-hearted and callous, without consideration for other people. (Mises 1963, 270, my italics)

Mises further characterizes consumers as "unfeeling and stony hearted" and emphasizes the subordination of all production to their demands (ibid., 273). But, as Mises acknowledges, a consumer is not the same thing as a human being. Both "consumer" and "human being" are abstractions, but the former focuses upon a much narrower range of behavior than does the latter. Being a consumer is a single aspect of being human.

Yet the more impersonal market relations become, the more accurate Mises's description is. To the extent that social relationships are purely anonymous, all we have to go on in making decisions are our personal desires, to which the intrinsically valuable aspects of more personal transactions are subordinated. As anonymous consumers we do not know anything about those with whom we are transacting. Therefore their concrete needs and circumstances will not enter into our calculations. The goals we seek to realize become completely divorced from the well-being of those producing the products and services competing for our attention.

It cannot be otherwise. The ever-growing complexity of a liberal market order is too great for us to have any but the most fragmentary and often misleading knowledge about the producers of most of what we consume. Therefore, the economic impact of our decisions upon those other people will be the same as if we were "unfeeling and stony hearted."

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This situation has disquieting moral implications, implications hidden by an analysis that naively equates human beings with consumers. The problem rests with the partial nature of the market order compared to the full richness of human life.

Let us return to the classical liberal case for the market. Much of the ethical case for liberalism, and for the market in particular, is based upon the formal voluntariness of relationships in the liberal community and the market subcommunity. But in a market place such as a crafts fair, this voluntariness takes the form of a face-to-face community rooted in a relatively small and comprehensible geographic setting. The market order, as distinguished from the market place, has no fixed social and geographical location. It encompasses the entire globe and billions of people. A market place is concrete; the market order is abstract.

Economic efficiency is always a value in exchange relations. However, in a market place other values moderate and condition it. For example, in 1995 a grocery strike took place in Northern California. In the small town of Guerneville, Safeway is the only grocery store. Because there were no nonstruck supermarkets within several miles of this town, many of Guerneville's citizens drove the extra distance to support the striking salespeople who lived in their community and whom they saw every day.

Of course price mattered to these shoppers. All else being equal, like the rest of us, they would have patronized the store with the lowest costs in terms of convenience and dollars. But all else is not always equal, and when it is not, the small scale of a market place enables one more easily to factor these other values into one's economic decisions. Prices are vital but imperfect measures of the values consumers associate with particular items.

Where economic efficiency overwhelms other values, the market place has been subsumed by the market order. When this has happened, we have moved from a community held together in part by personal relationships to one held together by impersonal ones.

Impersonality often grows through changes at the margins. It is rarely deliberately chosen. A competitive market of small, individually owned stores will tend to have a relatively low rate of profit; when innovations enable retailers using large-scale orders to obtain lower prices, established stores will not suddenly lose all their customers to the new competitors. Some customers are more loyal than others. Only those customers who are the most price sensitive

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will shift. But to the extent that these marginal customers are crucial for the survival of the smaller stores, they will cease to survive. Many consumers who preferred shopping at the smaller stores will then have to shop at the larger one.

Over time retail outlets have tended to grow in size from "mom and pop" stores to medium-sized chains to large chains to megastores. In the process, products have become cheaper and more varied, while human relationships have become more impersonal. The consumer is better served, but the depth of human relationships has become more shallow.

Small stores whose owners possess personal knowledge of their customers can perform a variety of services that are not easily factored into the price system. For example, streets are safer when there are many small enterprises and pedestrians. But since no single purchase will have much impact on these "externalities," they are ignored in pricing (Hardin 1985, 110). Just as the person who preferred lower prices and impersonal shopping was subsidizing the person who preferred personalized service even if the prices were higher in the small stores, so now those who suffer from greater crime are bearing the external impact of large impersonal megastores. Prices simplify the information consumers need to make choices, but by definition, any simplification eliminates something. And what is eliminated may be important.

The growth of the market order and other impersonal social processes is neither all gain nor all loss. Values and ways of life focusing only on the personal are not always superior to more abstract arrangements. Hatred as well as love is personal. The impersonality of market and other anonymous liberal orders has liberated us from stifling social pressures and prejudices. But it also liberates us from supportive social networks. The two go together.

My point is not that one way of life is better than the other, but that each serves values slighted by the others. Therefore, if the liberal community, including the market order, favors one set of values over another, particularly in ways that are not immediately obvious to its participants, it cannot be said simply to facilitate exchanges. It also helps shape those exchanges by altering the context in which they are made. And we are justified in asking whether that change is entirely to our liking.

The market order allows cooperation to grow in complexity, because we do not need to agree on as much as when relationships

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are personal. We need only agree about specific transactions considered separately from their larger context. As the complexity of interpersonal cooperation grows, its personal depth falls. Complexity and depth (as I am using these terms) are inversely correlated.

Consider in response a defense of the market-neutrality thesis by James Buchanan and Viktor Vanberg, who contend that

> the market economy, as an *aggregation*, neither maximizes nor minimizes anything. It simply allows participants to pursue that which they value, subject to the preferences and endowments of others, and within the constraints of general "rules of the game" that allow, and provide incentives for, individuals to try out new ways of doing things. There simply is no "external," independently defined objective against which the results of market processes can be evaluated. (Buchanan and Vanberg 1992, 181)[10]

Buchanan and Vanberg rightly emphasize the creativity of the market process. The market's openness to individual creativity makes it fundamentally unpredictable. But in justifiably attacking "teleological" defenses of the market, which hold that their participants are likely to discover objective exchange opportunities that are "out there" waiting to be exploited, the authors go much too far in the direction of indeterminateness.

Buchanan and Vanberg suggest a thought experiment to illustrate their point. Suppose that people lived in a society where no material goods existed, but where, once appropriated, possession of physical resources would be respected. Under such circumstances, many people would begin thinking about how they might improve their lot by making exchanges with others. Each would ask, "'What can I produce that will prove of exchange value to others?' . . . Individuals would use their imagination . . . in producing goods wholly divorced from their own consumption, goods that are anticipated to yield values when put on the market." This hypothetical illustrates how "markets tend to satisfy the preferences of persons, regardless of what their preferences might be. . ." (1992, 181–82). The market is not teleological because nobody can know what future state it is approaching. The reason is that many future states are possible, but the one that will occur will arise from unpredictable creative acts by market participants.

Buchanan and Vanberg's argument, however, conceals a subtle bias. Their imaginary example deals only with goods that are pro-

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duced because someone else wants them. To the producer alone, they are worthless. The market order favors the creation of such exchangeable goods at the expense of non-exchangeable ones. To say that we cannot predict what specific form market goods will take is different from saying we can predict *nothing* about them; for we *can* predict that they will have a bias toward exchange values. The market order is biased towards serving certain kinds of cooperation and certain ends, not others. Consequently, we can make qualitative evaluations of the market order.

Evaluations such as this do not entail arguing that some particular non-exchangeable value trumps all others. Moreover, *every* social context favors some values over others. Because every useful standard exists within a context, no context should be uniquely privileged for all questions. The market process takes place within a social and environmental framework that both modifies and is, in turn, modified by it. The market is no more value neutral than any other social institution, and so no claim to exempt it from evaluations of its biases can be reasonably justified.

Liberal and Other Communities

Within the liberal community, there is an unavoidable tension between the values privileged by the market, democracy, and science. But the liberal community is only one of the basic communities in which we live. As the liberal community expands, these other communities come increasingly to be influenced, and even dominated, by market, scientific, and democratic processes.

At the borders between liberal and other communities, the effect of subordinating other values to efficiency is quite different than it is within the market order. In the family, in the neighborhood, and in nature, efficiency is not the primary value. While usually important, efficiency is, in these contexts, subordinated to other values. I will use the natural world to illustrate this point because nature is the community that is most completely removed from the liberal community. Yet the same basic tensions will also be found between the liberal world, on the one hand, and the family and other personal communities, on the other.

Steven Jay Gould writes, of the magnificent variety of life that has evolved in nature, that

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> the watchwords for creativity are sloppiness, poor fit, quirky design, and above all else, redundancy. . . . Bacteria are marvels of efficiency, simple cells of consummate workmanship, with internal programs, purged of junk and slop, containing single copies of essential genes. But bacteria have been bacteria since life first left a fossil record 3.5 billion years ago—and so shall they probably be until the sun explodes.

Gould concluded that if evolution operated primarily on the basis of efficiency, it "would generate no structural complexity, and bacteria would rule the world" (Gould 1990, 15, 18; see also Worster 1977, 291–315). If Gould's analysis is correct, then were efficiency the ultimate value in nature, we would not exist.

In the world of nature, adaptation to change operates through a process of continuous mutual adjustment. Because of its reliance upon abstract procedural rules within which each person can act as she or he sees fit, the liberal community adapts in a similar manner. At this level there is a systemic harmony between the natural and the liberal community that sets the latter apart from communities dominated by organized hierarchies, prescriptive rules, and attempts at deliberate control. To the extent that industrialized liberal societies have been less environmentally destructive than illiberal ones, this may be the reason.

Yet this complementarity has important limits. Natural and social processes constitute different systems, even though one emerged from the other, which continues to sustain it. Most natural adaptation proceeds through generational change, and can occur no faster than can physical reproduction. Most human adaptation occurs far more quickly, because it is generated by changes in information that lead to intragenerational learning. More than other forms of human society, liberal communities both generate and coordinate vast amounts of information, allowing unknown and unpredictable people maximal opportunities to make use of creative insights. The pace of change is therefore faster than in other societies. From the perspective of individual human beings, the difference between human societies and nature is all to the good. In nature, individuals who fail to adapt die. In society, individuals who fail to adapt suffer a loss of systemic resources. They must find new jobs, support new policies, or abandon old theories on pain of becoming systemically irrelevant. In liberal societies, it is companies, political causes, and

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scientific theories that die, not the human beings associated with them (Rothschild 1990, 213–25).

This distinction between adaptation in nature and in human society, however, while enormously beneficial, carries with it the continual risk that social adaptation may become critically dissociated from natural adaptation. Compared to other societies, liberal society's greater rate of change increases not only intrasystemic adaptation but the risk—and the possibly devastating consequences—of extrasystemic dissociation. Its strength can become a weakness.

Primarily because it does not focus on individual physical survival, but rather on enabling individuals to reap the advantages they can extract from any opportunity they perceive, social change in the liberal community cannot help but take a shorter-term perspective than natural adaptation. It is more creative and less conservative. But these advantages do not come free of cost. Its very kindness towards individuals disconnects the liberal community's systemic priorities from those of spontaneous natural orders. The liberal community also myopically serves the advantage of living individuals, or at most their children, often neglecting that of future generations.

The negative impact of this myopia is more important when societies have a substantial impact upon the natural environment that sustains them. From ancient Sumer to the present, civilizations have tended to destroy their sustaining natural foundations. Exceptions have been due more to fortunate peculiarities in the physical environment than to the wisdom of their institutions. For example, until the Aswan dam was built, the Nile's floods regularly replenished the soil and carried away dissolved salts from Egyptian farmland. Cultures in the Fertile Crescent were not so fortunate, and so exhausted much of their land millennia ago.

Liberal societies have been spared the worst of the depredations that afflicted other industrial orders. The democratic process and the legal protection of property rights have been the major means by which those personally harmed by environmental destruction have been able, in part at least, to resist the plans of the powerful. This, presumably, is why today the United States and Western Europe do not resemble Russia environmentally.

But as more and more of the communities within which we live become dominated by the liberal one, this ability to resist degradation is weakened, for the multidimensional world of private property in the market place is transformed into the one-dimensional

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world of corporate property in the market order. A subtle, adaptive, and complex set of ethical relationships rooted in personal responsibility for nature is swallowed up by a simple, abstract, and legalistic order. As the social community becomes increasingly decoupled from nature, the information guiding change no longer reflects knowledge of natural processes. Liberal society may remain marvelously adaptive by its own standards while becoming increasingly parasitic in its relationship to the natural world.

Adaptation always occurs within a context, but the circumstances that determine whether survival is possible are not always respectful of that context. The context provided by the liberal community does not weight individual choices toward the respect and maintenance of natural processes. People's short time horizons and the sheer quantity of more pressing and more immediately "relevant" information generated by the market order guarantee that natural processes influence social adaptation only with great difficulty, except when those processes are in a state of collapse.

As it is conceived in our society, self-interest is inherently incapable of generating ecologically sustainable behavior. The secular worldview encouraged by science, democracy, and the market alike weakens ethical and cultural constraints against taking advantage of every perceived opportunity for personal gain. And the impersonal character of the spontaneous market order makes it difficult for anyone acting within it to weaken the forces that elevate serving the consumer above all other human roles.

Some have observed that the long-run viability of the liberal community depends upon a framework of moral constraints and values that it is itself incapable of generating or sustaining. Usually this charge focuses on ethical values that structure relationships between human beings. But the liberal community also dissolves institutional constraints on our behavior toward the natural community. If this argument is basically sound, both people and nature need to be protected from the transformative biases of the liberal community. Countervailing power needs to be developed. Given the institutional amorality of corporations, bureaucracies, and, indeed, of all large organizations, this power needs to be quite strong. Its ethical basis—perhaps the most important contribution of the environmental movement[11]—must transcend the span of a human life. But adequate institutional expressions of such principles need also to be developed. One institutional form that historically has

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generated sustainable behavior, or at least a greater approximation to it, is a certain kind of small-scale, face-to-face, and reputational community that integrates individual self-interest with community standards. For example, in Switzerland and Japan, local self-governing villages have successfully managed their common forest and pasture land for as long as 800 years (McKean 1992, 63–98; Ostrom 1990, 58–69, 88–102).

In recent years the environmental failings of the liberal state have been subjected to withering exposure and criticism. In response, libertarian policy analysts have proposed market-based approaches to solving environmental problems. To be sure, market-based environmental incentives are often more adaptive and sensitive to local conditions than the centralized regulations they replace. But this superiority has led many to argue that the market order as such is environmentally friendly, or at least that it can be, once property rights are properly adjusted. They argue that the language of economics is sufficient to craft viable environmental policies. This view is mistaken.

The problem is neither state nor market, but rather the abstract nature of the liberal community, which operates on principles divorced from those of the natural world. None of its defining institutions can provide a reliable foundation for ecologically sustainable interactions with the spontaneous order of nature. Left to its own devices, liberal society is not harmonious with natural processes, and is too powerful to refrain from subjecting them to its sway. But the economic, political, and epistemological systems forming the liberal community are not the only spontaenous orders we need to preserve.

The distinction between the market place and the market order offers a way for different spontaneous orders to coexist. The face-to-face societies of the market place, the neighborhood, and the small community function as far more sensitive evaluators of competing ends than does the market order and its corporate institutions. Efficiency is not unimportant, but neither does it come close to being all-important. Placing greater reliance on the role of face-to-face and reputational communities holds great promise for maintaining relationships with the natural order over the long term. Local communities not only possess more knowledge of local circumstances; they also can learn more quickly from their successes and failures.

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What is necessary for such communities to perform these functions successfully is not only rapid feedback about the impact of their actions. They also need to be able to defend themselves and their boundaries from the abstract orders of the market, science, and democracy. Nature and the other communities in which we live must be provided with sufficient means to resist the encroachments of liberal orders every bit as much as liberal orders, to work well, must be protected from the impingement of illiberal organizing principles.

NOTES

1. I believe Hayek missed the significance of this because he did not see that liberal society is itself a network of spontaneous orders. Although he saw that both science and the market were spontaneous orders, he failed to grasp the deep systemic differences between liberal democracy and other forms of government. See diZerega 1989, 206–240; 1994, 57–86.
2. Jacobs 1992 is perhaps the best single work on the moral foundations of science and the market. While Jacobs considers politics as requiring what she terms "Guardian" rather than "Commercial" ethics, the ethics of the democratic process is actually quite in keeping with Commercial ethics as she develops them, while the ethics internal to political *organizations,* such as political parties and bureaucracies, are indeed Guardian in nature.
3. This point, made most insistently by the Popperian W. W. Bartley, III (1984), seems to me unassailable, regardless of how one judges the controversy between Habermas and philosophers of science working in the tradition initiated by Karl Popper.
4. Nowhere is this confusion more evident than in egalitarian democratic theory, which argues that substantive equality among citizens is an ideal by which existing democracies can be legitimately evaluated. For extensive discussions of this issue see diZerega 1988 and 1991.
5. Much of the responsibility for this failure must also be shared by many market advocates, who frequently emphasize competition as fundamental to the market when in fact it is a secondary characteristic, arising out of preexisting cooperation. See diZerega 1992, 322–24.
6. There is a similarity between this argument and that put forth in Michael Walzer's *Spheres of Justice.* Walzer emphasizes, correctly I think, that when various social goods "are distinct, distributions must be autonomous . . . [and] only certain criteria and arrangements are appropriate" (Walzer 1984, 10). Distribution in violation of these criteria is unjust.

   Walzer analyzes both self-organizing systems, such as the market, and instrumental organizations, such as a church hierarchy, from this perspective. By contrast, my approach views the tension between the liberal com-

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munity and other basic communities, and that between the constitutive spontaneous orders of the liberal community, as unintended, systemically generated outcomes. This unintentional dimension makes biases in spontaneous orders quite distinct from biases in instrumental organizations. The latter express the views of a power elite. The former reflect abstract values not necessarily connected with the particular purposes of *any* participant.

7. I owe this felicitous way of expressing the difference to Karl Hess, Jr. One of the clearest discussions of the tensions between the market place and the market order is McConnell 1988.
8. Of course, "self-selected private individuals" are always crucial in deciding what the "social interest" is. They are called active citizens. The alternative, which I doubt Friedman would condone, is for only elected officials to be free to determine what constitutes the social interest.
9. Peter Drucker (1993, 101) appears at first glance to disagree with Friedman. But much of this disagreement is terminological. Thus Drucker writes that "economic performance is the *first* responsibility of a business. A business that does not show a profit at least equal to the cost of its capital is socially irresponsible" (101).
10. See also Kirzner 1990, which argues that the market process simply "generates greater mutual awareness" among participants, thereby helping them better to coordinate their opportunities for cooperation (34).
11. I have tried to make this argument with minimal attention to ethical positions other than long-term self-interest. However, I believe that a strong case can be made for ecocentric ethics, and that liberal ethics are most appropriately viewed as a subset of them. See diZerega 1996; 1995a; and 1995b.

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WAS HAYEK AN INSTRUMENTALIST?

ABSTRACT: *In Hayek's* Social and Political Thought, *Roland Kley argues that Hayek's defense of capitalism is instrumentalist: that is, that Hayek sees market societies as efficient mechanisms that have no independent ethical justification. But in fact, Hayek does have such a standard, one that is expressed in the notion of a discipline of freedom. This standard derives from the moral anthropology of the liberal-conservative tradition.*

In a certain respect Roland Kley's *Hayek's Social and Political Thought* (Oxford: Clarendon Press, 1994) is tediously predictable. Page after page, section after section tells us that Hayek's theses are "hardly comprehensible," "implausible" and "fatally flawed," that his theory "founders," "crumbles," and "aborts," that his conclusions are "foregone," that each argument he raises is "untenable," "weak," "self-defeating." When in the concluding parts of his book Kley argues that Hayek's theory is essentially instrumentalist, one cannot help feeling that this last charge is superfluous to the overall critique; instrumentalist or not, this theory must be regarded as indefensible since all its constitutive parts have been previously demolished. The picture of Hayek's philosophy as it emerges from Kley's book is that of

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a gigantic intellectual failure that hardly justifies the effort to refute it.

The structure of the book, in which each chapter and subchapter, each comment on each part of Hayek's theory, is followed by a critique, is a methodological trap, constraining the author to produce rebuttals almost automatically, even when there is no obvious need for them. This compulsion to score as many points as possible is probably the major reason that many of the book's arguments are unpolished; that some are methodologically inconsistent (intrinsic ones are mixed with extrinsic, empirical with analytical, etc.); and that several are unnecessary or simply false. Those arguments that are valuable and interesting become lost in a chaotic and indiscriminate series of critical punches. Kley's study certainly has not reached the standard set by other books on Hayek written during the last fifteen years (Barry 1979; Gray 1984; Kukathas 1989).

Hayek's Epistemological Economics

Let us illustrate Kley's method by considering his refutation of what is considered to be Hayek's major insight into social theory: the epistemic role of the market. According to Hayek, the indispensability of the market is primarily epistemological: it helps to discover, utilize, and develop knowledge. To support this claim Hayek offers several arguments, of which three seem to me the most interesting. The first of these derives from economic calculation: only the market generates the conditions in which a system of prices, being a reflection of countless individual transactions, gives us reliable information about the costs and benefits involved in any economic undertaking. The second argument stems from plurality: market society is sufficiently diversified in opportunities to create a demand for individuals' knowledge and abilities, which would be ignored in a less pluralist system and which, when utilized, enrich the general pool of knowledge and open up possibilities for other individuals. The third argument is from evolutionary adaptability. In the process of history, individuals have developed abilities and gained skills—often passed from one generation to another within families and other small communities—that enabled their adaptation to the social and natural environment and constituted practical knowledge of how to handle those unique problems that are char-

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acteristic of a given social group or a given set of historical circumstances; the market, by dispersing authority, increases this social potential, making for greater responsiveness to reality.

The epistemic role of the market is, if I am not mistaken, the only aspect of Hayek's philosophy for which Kley has some—albeit, few—positive words to say (though ultimately these words further *reculer pour mieux sauter* tactics). The epistemological argument, he notes, "seems extremely powerful" (57); "it is . . . an original contribution of Hayek's to have demonstrated that only in markets and in a market price-system do the relative scarcities of resources and goods find expression accurately and promptly enough to make efficient production and allocation possible, thereby advancing general welfare" (199). Kley's apparent admiration for Hayek's epistemological argument extends only to the thesis that economic calculation is possible exclusively in the market. This thesis is not original to Hayek; Ludwig von Mises is usually credited with its formulation. What Hayek did was to complement Mises's argument by recognizing that economic calculation is a "discovery process, developing and spreading otherwise unavailable, latent information that is part of price formation by a multitude of economic agents" (de Jasay 1990, 11; also Lavoie 1985, 158-73). Kley finds little value in the other two arguments: that the market affords more opportunities for the use of individuals' knowledge, and that it induces people to acquire and to transmit adaptive skills.

The main objection Kley raises against Hayek's epistemic argument is that it "in no way goes sufficiently far to justify *liberal* institutions" (199, italics his). One cannot help noting—before any concrete assessment of the objection is made—that it seems somewhat mistargeted. It is not at all clear that Hayek intended his argument to answer these notoriously difficult questions, and one may wonder whether any one argument could possibly answer them. Moreover, there is nothing in the epistemic function of the market that would suggest direct and specific institutional conclusions rather than general guidelines; no epistemology can have such obvious practical application.

One gets the impression that the major reason for Kley's early praise of the epistemological argument as "powerful" was to allow him to launch a critique along the following lines. If the argument is "powerful," then it should solve difficult problems. It turns out that the argument does not solve those problems, e.g., it does not

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tell us who should build opera houses and whether to curb pornography (60-61); so we have to conclude that it is not so powerful after all.

On the other hand, Kley is no more satisfied when Hayek's theory permits a more specific implication. The epistemic function of the market clearly favors a great number of economic agents, which in turn strongly implies a system of private property. In that sense one can say—contrary to Kley's initial objection—that Hayek's argument "goes sufficiently far to justify" at least one liberal institution, that of private property. Yet Kley asserts that "at least in theory" markets may be grounded on other property arrangements (59). Whatever the merits of this claim, it amounts to saying that Hayek's thesis is in fact too specific in its institutional implications. At this point Kley's critique ceases to be an intrinsic assessment of Hayek's theory and becomes extrinsic: there are better theories than Hayek's, judged according to non-Hayekian criteria, such as the need for a large public sphere. This may be true, but Kley does not substantiate it with a single argument. Moreover, having conceded to Hayek that "only in markets and in a market price-system do the relative scarcities of resources and goods find expression accurately and promptly enough to make efficient production and allocation possible, thereby advancing general welfare," the *onus probandi* rests on Kley to show that a property system other than the one favored by Hayek would perform the epistemic function—Hayek's criterion—at least equally well as some theoretical alternative.

With respect to the liberal state—the other liberal institution about which Hayek's thesis allegedly fails to be sufficiently unequivocal—Kley's case fares no better. At first he mentions two specific problems about which Hayek has little to say: the limits of the consumer's freedom (the consumer may desire products, such as pornography, which are socially damaging or morally dubious), and the question of public goods. The Hayek Kley gives us could hardly have any solutions to such problems, since his epistemic argument is reduced "essentially [to] the contention that only market competition can discover the relative scarcities of resources, establish a price-system mirroring them, and thus provide the information needed for an economy efficient and sensitive to people's wants" (63). Obviously, the knowledge provided by prices cannot say anything about the importance of spending tax money on an opera

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house or about the damaging effects of pornography. Such judgments cannot come from the price system—and Hayek never said they could. They must stem from the rules that constitute the legal and moral order of a society.

Summing up his critique of Hayek's epistemic argument, Kley makes a more general point: "Hayek's epistemological considerations are by themselves inconclusive and do not furnish a general argument against any interventionism" (62–63). While Kley concedes that "government intervention may indeed distort the price-system," he goes on to claim that "nothing Hayek says excludes the possibility of endogenous market disturbances and informational uncertainties which only government action can abate" (62). Previously he argued that there are certain specific problems which Hayek's epistemological thesis, although "powerful," cannot solve. Now he contends that the thesis does not give us any *general* grounds against *any* interventionism. This contention not only does not follow from the claim that disturbances and uncertainties may call forth government intervention as an exceptional measure, but it is false as an interpretation of Hayek.

Hayek's epistemological argument clearly excludes the possibility that the state would *systematically* act as a corrective to the kinds of market failure Kley briefly mentions. The government cannot intervene for the sake of social welfare if this would mean tampering with the general rules of cooperation; its role is to defend those rules rather than to manipulate them in order to achieve particular ends. Here Hayek's position is in line with that of several prominent twentieth-century German liberals, particularly of the so-called Freiburg School (Vanberg 1994, 454–57). Looked at differently, Hayek's position may be compared to a certain version of the subsidiarity principle. The primary agents are individuals, communities, and voluntary associations; if they fail, there is a possibility for a government action; but if the government intervenes, it is preferable that action be taken by "local authorities," which would generally offer "the next-best solution where private initiative cannot be relied upon to provide certain services and where some sort of collective action is therefore needed" (1960, 263; also 1979, 41–51). Kley is perfectly entitled to reject this notion of the state, but he cannot claim that Hayek has little to say about government intervention.

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Famine and the Epistemic Argument

Strictly speaking, Kley has only one argument that may serve to undermine the epistemic role of the market. There are situations, he says, when "people get the price signals wrong," which in turn might result in a drastic market failure. "Hayek never considers the possibility," Kley writes,

> that massive market changes may leave large parts of a population suddenly without access to the most basic goods. But, as Amartya Sen has argued, this is precisely what happened in various famines. People died not because the aggregate availability of food had fallen but because huge price shifts had put it above their reach. Martin Ravallion has analyzed one such case, the 1974 famine in Bangladesh, and concludes that the rice prices were high and unstable largely as a result of speculation. . . . Now, to be sure, market situations of this sort may be exceptional in various ways. Still, the example drastically demonstrates that there is more to individual adjustment than the informational side Hayek stresses. Moreover, it points to limits of adjustment, showing that sometimes no amount of individual flexibility will suffice to enable people to link up again with the existing web of exchange relations. Finally, it also warns against making the claim about the market's informational capacities an article of faith. (66)

Upon inspection, there is less here than meets the eye. If the epistemological argument is indeed powerful, then one would expect an effort to relate the market's informational capacity to the famine in Bangladesh; in other words, one would expect an explanation of how this particular empirical fact should make us reevaluate the analytical assertion about the market's epistemological function. To say that "there is more to it," and that this function should not be "an article of faith," is far from satisfactory.

In saying that "massive market changes may leave large parts of a population suddenly without access to the most basic goods," moreover, Kley implies that the market may be the cause of the famine. But while there is no doubt that the state was the sole agent responsible for the gigantic famines in the Ukraine following the Russian Revolution and in China during the Great Leap Forward, it cannot be argued that the market bears responsibility for the famine in Bangladesh. Sen and Ravaillon contend that the mar-

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ket was unable to *cope with* the famine, and sometimes aggravated it, but they do not say that the market produced it. If, as they maintain (Sen 1981, 131-66; Drèze and Sen 1989, 27-30; Ravallion 1987, 1-23, 57-83), the high price of rice in Bangladesh was the result of mistaken anticipations of future prices, it does not in any way contradict the epistemic role of the market. Nothing in Hayek's theory would suggest that people cannot "get the price signals wrong," especially in the face of floods, political crisis, and social upheaval. If, in a certain situation, people get the price signals wrong, it does not mean that there is a more reliable and universally applicable instrument to get them right.

Hayek's Instrumentalism

To review a book like Kley's, where there is no clear organizing principle, is a thankless, if not impossible, task: a thorough analysis would require that all its arguments be enumerated and given a separate assessment. Since I cannot do that, I will take up the only idea in Kley's book which, hypothetically at least, might give it a unifying structure: an instrumentalist interpretation of Hayek's thought. That such an interpretation was the intention of Kley's project we learn in the Introduction. Unfortunately, in the subsequent portions of the text the concept of instrumentalism virtually disappears and does not reappear until the concluding part. There, to our surprise, we find the author saying that he had been arguing for the instrumentalist interpretation of Hayek all along (183), a claim unwarranted by the actual content of the book.

As to why Hayek's thought is instrumental, Kley explains that Hayek

> thinks liberalism is the right political doctrine because, unlike socialism and other collectivist creeds, it is committed to institutions that do take account of the social world as it is. He even deems the liberal market society the only feasible alternative because it alone admits of those self-co-ordinating mechanisms, such as the market, on which modern society vitally depends. Similarly, he portrays the institutions of the liberal market society as the work of a singular evolutionary development in the course of which they have proved their value and wisdom. So it is concerns of viability that are decisive when, in his political philosophy, Hayek endeavors to justify the

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> institutions of the liberal market society. Feasibility considerations are characteristic of instrumental reasoning. (184)

Let us summarize Kley's argument: (a) Hayek believes that liberalism, unlike socialism, "takes into account the social world as it is"; (b) from this it follows that his main concern is the "viability" and "feasibility" of institutions; (c) such concerns are typical of instrumentalist thinking; ergo, Hayek is an instrumentalist.

I have serious doubts about this argument. First, it should be noted that (a) is very vague while (b) contains an ambiguity. Feasibility and viability are not identical; communism, to give an example, was feasible but it was certainly not viable. Consequently, (a) and (b)—if the latter is limited to feasibility—generate an extremely weak notion of instrumentalism which could be applied indiscriminately almost to any position. All social and political theories "take into account the social world as it is," in the sense that none is created in a blatant indifference to what the world tells us. The whole point of controversy between Hayek and the socialists was not about taking or not taking into account the world as it is, but about what constitutes the "as it is" of the world. Even the most bizarre conceptions of the ideal human order—for instance, Plato's ideal *polis* or Fourier's phalansteries—were thought to have been derived from an accurate diagnosis of reality. All of them were considered to be feasible. At the same time one can claim with equal persuasiveness that all theories—even the most conservative ones—"take into account the world as it should be," since they reject some aspect of the status quo in the name of an optimal standard. Hayek's *Road to Serfdom*, which contained a call for a thorough reform of capitalism, is a case in point.

To improve the argument we may dispense with "feasibility" and take (b) to mean "viability," if this signifies the ability to foster "self-co-ordination." We would then say that an institution is viable if it is able to generate and sustain itself without the interference of an external factor, such as, for instance, a government. Socialism, according to Hayek, was not viable, that is, it did not develop the mechanisms of self-generation and self-sustenance that would have given its institutions a sufficient stability; for that reason it was bound, sooner or later, to fall apart. On this interpretation we begin to understand what Kley means by "the world as it is." Hayek—the argument would run—accepted and promoted only those institu-

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tions that, through a long process of adjustment and improvement, have become more in tune with the complexities of the world; those that have not gone through this process—and are thus the product of a "constructivist" spirit, as Hayek would say—carry too little social experience and too little practical knowledge to withstand the pressure of reality. Viability is thus not only a technical notion—institutions that are viable are more responsive and have a longer life—but also has a metaphysical or quasi-metaphysical side to it: viable institutions give us a better insight into the nature of the social order.

This interpretation of Hayek is congruent with a lot of what he wrote, but it has one drawback from the point of view of Kley's argument: there is little in it in terms of instrumentalism. A similar notion of viability is found in many conservative writers (such as Russell Kirk and Roger Scruton) who, while having nothing to do with instrumentalism, also favor self-generating and self-sustaining institutions that have emerged through an evolutionary process of adjustment.

There is another way to interpret the quoted passage, one that modifies the previous version. The view ignores (a) as referring to an obscure problem of social ontology; as to "feasibility" and "viability," we can use these terms interchangeably to convey loosely the simple idea that, for Hayek, a social order is "a mechanism" that, by definition, should be judged by whether it functions properly, where the word "properly" denotes efficient coordination. Thus, when asked why he prefers some social and economic arrangements to others—capitalism to socialism, for example—Hayek would answer that capitalism provides a better system for coordinating political and economic agents. I believe this explanation is closest to Kley's intention, though, as noted, it does not seem to be entirely consistent with the text. In the quoted passage we are told that Hayek believed in an evolutionary process that gives a mechanism "value and wisdom." If so, one might say that he was not a strict instrumentalist, because he also relied on non-instrumental notions. Referring to "value" and "wisdom" presupposes that Hayek's order is not only operationally efficient, but that this efficiency is subservient to the good it produces (leaving aside the question what this good, i.e., this value and wisdom, might be). As other passages in the book show, Kley will argue that in Hayek we can separate the notion of the market as a coordinating mechanism

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from the notion of cultural evolution which creates "value and wisdom" (an argument I will comment on in the last part of the paper).

Hayek and the Fall of Communism

In order to find more in Kley's use of the category of instrumentalism one should turn to other, less ambiguous, formulations. Of the few that are available in the text, the most telling is the following one from the Introduction. "What is, in Hayek's perspective, distinctive about liberalism is less a particular set of moral and political concerns deriving from a powerful ideal of individual liberty than its unqualified espousal of the market and its system of rules. To be a liberal is, for Hayek a question not primarily of having the right political morality, but of possessing the correct social and economic theory and, therefore, endorsing the only effective co-ordination mechanism. Liberalism is an instrumental doctrine" (8).

Here, as in the last of the above interpretations, Hayek is said to be an instrumentalist because, for him, the superiority of the liberal order consists in its efficient mechanism of coordination. To this two more points may be added which are stated explicitly in this as well as other passages. First, in Hayek there are no "moral and political concerns" derived from some independent ethical standpoint, irreducible to the criterion of efficiency; especially it would be a mistake to attribute to Hayek the view—typical of liberals—that the independent ethical standard for political and economic institutions is some notion of individual freedom. Second, the preoccupation with efficiency at the expense of the moral principles that underlie the value of individual freedom makes Hayek liable to an even more serious charge. He was not only an instrumentalist, but also a holist (68): what mattered to him was the evaluation of whole social systems (such as capitalism and socialism), whose efficiency could be measured by the degree to which they secure peace and prosperity.

Let me start with the last two points. They amount to a rather one-sided view of Hayek and one that would be difficult to defend consistently. A holist attitude is there, to be sure, but Kley makes too much of it. We should not forget that until relatively recently, much free-market philosophy was formulated within the context of

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the East-West communism-capitalism conflict, which inevitably gave them a partly holist character. Even in Ludwig von Mises's aprioristic theory of the market, which was definitely more individualistic than Hayek's, one could find a holist tinge. Kley is of course not unaware of this historical circumstance, but he tends to see it as spawning simplified dichotomies that, characteristically, he dismisses with the epithet "Manichean" (4).

But a dualistic perspective need not be identical with political-economic Manicheanism, and in so far as they both overlap, it need not support the charge of instrumentalism. What the menace of the communist system induced was, indeed, a shift from conceptual nominalism in the interpretation of the market (to which capitalism based on self-interest and individualism has always been prone) to conceptual realism. The latter position, however, by no means obliges us to embrace an image of capitalism as an efficient mechanism of coordination securing peace and prosperity, irrespective of individual freedom. Although, having taken this perspective, we are undoubtedly inclined to view capitalism as a distinct whole—and because of this holistic tendency we might be suspected of betraying its individualistic spirit—this whole is a cultural entity, the civilization of freedom, whose essence could be best grasped in contrast with totalitarianism. Should one look for Manicheanism here, one would find it in a contrast between freedom and serfdom, rather than that between efficient and inefficient mechanisms of coordination. But once we take this position, we are less—or not only—concerned with black-and-white morality (no matter how justified it might be), and more with the theoretical project of identifying and depicting the forces that have generated and sustained a free society. If that approach is holistic, so be it, but it is certainly not instrumentalist in the above-defined sense. My quarrel with Kley's view is that it makes Hayek, at best, an un-self-conscious or, at worst, a dishonest thinker who, while writing about the road to serfdom, the constitution of liberty, and an order of a free people meant in fact something different, namely, the road to poverty, the constitution of prosperity, and an order of efficiently cooperating economic agents.

It may very well be that with the fall of communism, the idea of the civilization of freedom has lost the conceptual and cultural distinctness it once was believed to have, so that the search for its foundations would now be carried out in a less "Manichean" way.

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Such a project, however, has no appeal for Kley, nor, apparently, did it ever. In a short paragraph referring to the collapse of communism, he contends that Hayek's theory has limited "explanatory relevance": the revolution in the Soviet bloc—Kley maintains—was primarily political, focused on the ideas of "citizenship, public discourse, individual rights and procedural fairness," and triggered by "the notorious discrepancies between official rhetoric and actual achievement" that was characteristic of Eastern European socialism (17).

Without minimizing the impact of the factors he mentions, Hayek's theory was equally relevant. He was unquestionably one of the political theorists who substantially influenced the way the Eastern European intellectuals began to view their situation and their objectives during the last decade of communism. What he made them realize was that the error of the ruling system was not a poor implementation of noble ideals. Hence "the notorious discrepancies between official rhetoric and actual achievement" came to matter less than the perception that the whole rationale of the social, political, and economic order under which they lived was essentially flawed. In other words, communism was now thought to be "unnatural" in the sense of being an ill-conceived, artificially constructed system that, since its inception, had been aimed against the form of social existence that generated the institutions of freedom. The categories of "spontaneous development" and "constructivism" not only helped articulate social experience, but led to a reassessment of the place that capitalism and socialism occupied in the Western tradition. From that moment on, freedom was no longer primarily a political postulate expressed in the rhetoric of liberation, but began to be viewed in terms of a larger legal and economic order based on a moral and intellectual tradition different from the one that animated the ideologies of socialism.

It should be also pointed out that the whole debate between the supporters of capitalism and the supporters of socialism had not been, for some time, focused on the efficiency/inefficiency dichotomy for the simple reason that few socialists seriously doubted which system is superior in that respect. The standard charge that Marxist and *Marxisant* circles (represented among others by the Frankfurt School and, in a much less refined form, by communist propaganda) raised against the free market was therefore not that it did not produce wealth but that, firstly, it had become anachronistic

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in the light of social and cultural processes, and secondly, that it was essentially inhumane (that is, unfair, alienating, spiritually impoverishing, etc.) precisely due to its impersonal, machine-like efficiency. The latter accusation had a further consequence. Whatever claims capitalism might have had to freedom, it was ultimately declared a failure: a man living in a society that is unfair, alienating, and spiritually impoverishing did not have real freedom. He was believed to be eager to trade what freedom he had for more meaningful values that a more humane system could provide.

What Hayek did was to challenge both of the above assertions. He dismissed the alleged anachronism of capitalism by positing a model of evolution that did not make socialism a more advanced, let alone an inevitable stage of social development. And he rebuilt capitalism's ethical foundation by reasserting what its adversaries persistently denied or minimized: that this system lives on and produces freedom, and that this freedom—merely negative and largely illusory, according to Marxists—should not be traded for supposedly more meaningful values, because it is a constitutive element of the whole order. By making those two assertions Hayek put the ideologues of socialism on the defensive: he made them appear, within the framework of his theory, out of tune with the times, unable to cope with the complexities of the modern world. Although this defect expressed itself in socialism's inherent inefficiency, it was in itself a by-product of something more basic—a misinterpretation of reality (here Kley's "the world as it is" formula might have some relevance). Similarly, on the ethical side one could argue that socialism's inefficiency stemmed from its suppression of freedom, which is the fundamental source of human creativity and the condition of meaningful existence. *Toutes proportions gardées*, one could make an analogous argument against slavery: it is inefficient not only, and not primarily because of an organizational failure—this might be at least partly redressed—but because it misinterprets the nature of social order, being therefore unable to withstand the pressure of change; and because it is ethically wrong in depriving people of freedom.

Evolutionism and Instrumentalism

To reinforce the view that what Hayek was after was in fact the efficiency of the *mechanism* and nothing more, with freedom playing a

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subservient role, Kley suggests the following interpretation. Hayek, he says, proposes two separate arguments: traditionalist and proceduralist. According to the first one, "the institutions of the liberal market society—being long-standing traditions of evolutionary origin—are indispensable for the survival of mankind even though a rational justification explaining what precisely their contribution consists in cannot be given"; according to the second one, "the institutional framework of the liberal market society and self-co-ordination in the market" are indispensable because "they alone are capable of dealing with certain circumstances of modern social life in a way that secures general prosperity and social peace" (185).

In Kley's view both arguments are essentially instrumentalist, which again is somewhat puzzling. Whereas one can easily attribute instrumentalism to the second argument—the market may indeed be conceived as a set of procedures of economic cooperation whose efficiency is measured by the degree to which it secures prosperity (although, as the previous section showed, it is doubtful if this view applies to Hayek)—one should hesitate to characterize the first one this way. Traditionalism requires that people feel attached to their historically rooted institutions and practices regardless of whether these serve any rationally identifiable purpose, and certainly regardless of whether they secure prosperity, peace, or even personal happiness.

Kley explains why Hayek's traditionalism is instrumentalist in the course of a long and complicated argument that I have been unable to put into a coherent whole. Here are some of the points he makes:

(i) "The contours" of Hayek's instrumentalist traditionalism are according to Kley, the following. Hayek's "strategy is to identify an end shared also by the adversaries of the market and to show that only market traditions, but no alternative institutional arrangements, are capable of achieving it." This common end is "the preservation of mankind and the elimination of famine and poverty. . . . Since everybody endorses the end, everybody must also endorse the only effective means to that end: the rules and institutions of the market" (186).

To this one might reply that what Hayek proposes here is not the justification of the market institutions but an *ad hominem* argument against socialists. Since those socialists who envisaged capitalism as a self-destructive and economically polarizing mechanism would

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agree that the preservation of mankind and the abolition of poverty are essential criteria of evaluating institutional arrangements, it is natural that Hayek would press them on this point. The actual performance of the socialist economies, in contrast with the achievements of the capitalist economies, provides an argument too tempting not to be raised by market advocates; in fact it is used by most—if not all—free marketeers, regardless of their possible instrumentalist tendencies. The criteria involved are minimalist and largely negative. One cannot hope to *justify* capitalism solely on the grounds that people living under it do not die of hunger and do not destroy one another. This may, however, turn out to be a powerful argument against those who, like some socialists, promised to achieve much more but were unable to attain even this.

(ii) Kley maintains that Hayek's defense of the market is irrational, and can be made rational only on instrumentalist grounds. Here is his line of reasoning. He recapitulates Hayek's notion of his conceptual antagonist, "constructivism," which he characterizes by three tenets: (a) "all social institutions are, and ought to be, the product of deliberate design"; (b) "reason is sufficiently powerful to know, and simultaneously to take into account, all the details of the human conditions necessary to shape the institutions of society according to the preferences of its members"; (c) "all institutions not visibly serving approved ends . . . should be discarded," a tenet Kley calls "explanatory explicitness" (187-88). Kley makes two points about this last tenet: first, that Hayek, in rejecting the possibility of an explicit argument in favor of the market, in fact rejects any possibility of justification, rendering his defense of the market "a truly irrational undertaking and a pointless endeavor" that can only issue in "quietism and blind submission" (189); second, that "to maintain, against the constructivist maxim of accepting only what one *understands*, that we have never been able to comprehend moral rules *in the sense in which we understand how the things that we manufacture function* is to share with constructivism the idea that in principle, if one had the knowledge, moral rules could be understood analogously to how manufactured things work" (190).

The first two tenets of constructivism Kley leaves without comment, which might indicate that he, too, finds them objectionable. This is not a far-fetched conclusion, since they are extremely bold and easily challenged: there are institutions which are not the products of deliberate design, and reason cannot be sufficiently powerful

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to master all factors that make a good institution. Once we agree on that, we may find the notion of explanatory explicitness suspect and sympathize with Hayek's idea of the social process as the accumulation of practical wisdom, irreducible to explicit formulae. To have confidence in this accumulated knowledge and, consequently, in the institutions that are credited with carrying it need not be irrational; in fact, what would be irrational would be to search for explicit justifications after having rejected (a) and (b). Similarly, since explicit justification may not be possible, it would be unreasonable to claim that whenever it is impossible we are faced with "blind submission." This charge itself may arise only from the constructivist position, for which there is a sharp dichotomy between rational explicit argument and thoughtless quietism. Hayek's point is precisely that such a dichotomy is untenable.

This also undermines the last part of Kley's argument, which seems somewhat bizarre. The fact that one attacks the constructivists on the ground that contrary to their claim, "we have never been able to comprehend moral rules *in the sense in which we understand how the things that we manufacture function*" does not imply that by launching that attack we unwittingly share the constructivist principle that "if one had the knowledge, moral rules could be understood analogously to how manufactured things work." Considering that constructivism for Hayek is equated with a Cartesian epistemology based on deducing from absolute, self-evident first principles a chain of logical consequences, one could make a similar argument proving that Hayek is a crypto-Cartesian: whatever we know about our moral rules and social institutions is not knowledge that accords with Cartesian epistemology, but if we had the knowledge about those rules and institutions it would certainly be of the Cartesian type.

(iii) Kley argues that Hayek's evolutionism cannot give permanent sanction to liberalism and liberal institutions, as evolution is by definition an open-ended process. "Whatever direction institutional change takes, that theory can only note it and explain its occurrence as an increase in societal adaptiveness. It must trace liberal values and institutions back to a certain momentary environmental constellation which, if it changes, gives way to new values and institutions. From an evolutionist viewpoint, there is nothing special about liberalism" (192).

This is, I think, the strongest part of Kley's counterargument. The

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only reply one can make in Hayek's defense is that the criticism illustrates not really a weakness of the concept of adaptiveness (and indirectly of instrumentalism), but of evolutionism. If we resort to the category of evolution and want to avoid—as Hayek does—falling into historical determinism, with its belief in the inevitability and inexorability of historical laws, we have to admit that no social or economic order deserves a permanent privileged position. And although Hayek might have argued that the transition from capitalism to socialism is not really a spontaneous one, but results from the violation of the rules of cooperation, thus deviating from the evolutionary process, this argument does not have sufficient force. While it may apply to several historical circumstances, especially in twentieth-century history, it cannot be turned into a general rule. From the strictly evolutionist perspective, the market must be seen as something transitory; at least there is no way one can rationally prevent social expectations of new and alternative institutional arrangements. Another possible defense may also be put aside. Although Hayek tried hard to avoid the trap Kley notices by conceiving of evolution as a pattern of change or a framework within which all possible developments may spontaneously occur, rather than a set of specifications of what these developments will be, he could not succeed. The pattern of change is as likely to evolve as the vision of future history.

That said, a more general comment about the interpretation of instrumentalism Kley attributes to Hayek is warranted. Apart from the fact that neither the proceduralist nor the traditionalist arguments are as instrumentalist as Kley wants them to be, his view suffers from a more serious inadequacy, which is, interestingly, indicated *en passant* by the author himself. "Hayek," Kley writes, "does not himself distinguish the two arguments. Perhaps, he would even have insisted that they form a coherent though complex whole" (185). This is exactly right. I would say more: the whole point of Hayek's theory, by which it stands or falls, is precisely the unity of those two arguments.

A lot of what Hayek wrote was determined by the classical problem, going back as far as antiquity, of how to reconcile two apparently irreconcilable aspects of human behavior: freedom and order. His proceduralist argument, as I understand it, was responsible for the freedom part of his message: by concentrating on procedures, Hayek avoided any commitment to rigid hierarchies of ends, leav-

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ing their choice to free agents acting within a framework of rules that constitute the Great Society. The traditionalist argument, on the other hand, is not—contrary to Kley's claim—latently instrumentalist; it is conservative. Hayek's project developed in the context of reflection on the great derailments in the modern societies—a context he shared with many of his contemporaries, haunted by the specters of Nazism and Communism, as well as by their historical antecedents—which led him to believe that the only solution is a combination of individual freedom and accumulated social wisdom. As did many others before him, he turned to the British tradition, which seemed—especially in contrast to the totalitarian regimes that were then at the peak of their power—a perfect illustration of freedom being reconciled with an institutional tradition. The fact that Hayek talks of freedom in the conservative idiom of inherited social practices does not, then, mean that he did not have a strong independent ethical standard, that he diluted this standard in the impersonal forces of the market or historical processes, or that he identified it with the social status quo. For him such freedom was the only real type, that is, the only type that did not turn into despotism or an ideological ploy.

To separate the traditionalist perspective from the proceduralist one, as Kley does, is not only to deprive Hayek of the ethical force that his conception was meant to carry, but is to disregard the tension that characterized it. We cannot rely, Hayek said, on what we have received from the past because by pursuing our individual goals we are necessarily future-oriented; on the other hand, we are not free to think about the future solely in terms of the most effective means to realize our goals, because we ourselves are the products of the past, and this past, in the form of our cultural heritage, is the most reliable source of knowledge that we have.

Hayek clearly belongs to an important, though hard-to-classify, group of thinkers who tried to combine liberal and conservative ideas and are, therefore, often referred to as representing a "liberal-conservative" orientation. They did not form a school or a consistent doctrinal body; some of them were more conservative (like Burke), some more liberal (like Constant and Acton). Among Hayek's contemporaries this idea was popular among some German *ordo*-liberals, Wilhelm Röpke being the best-known of them. If there is anything that all these thinkers had in common, and anything that justifies the use of the otherwise clumsy and oxymoronic

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"liberal-conservative" label, it is their philosophical anthropology. All of them shared a certain conception of man, without which a good deal of what they said could be dismissed as intrinsically contradictory. The liberal-conservative world they depicted was possible because it was inhabited by liberal-conservative people. Most of these thinkers pointed to the British tradition (or, to be precise, to a certain interpretation of it), with its peculiar mixture of freedom and conservatism, in order to exemplify this anthropology and the forms of social existence it entailed.

Liberal-conservative anthropology describes people in antithetical terms because it is meant to account for the antithetical concept and the antithetical phenomenon of "a discipline of freedom" (Hayek 1979, 163-65). Hayek's human being is individualistically understood because individual innovation is, ultimately, the sole source of creativity and progress; yet he is also understood as a socially embedded being who never indulges in an adversarial attitude toward the rules that underlie the fabric of the social order. He does not believe in absolute ethics of the Platonic type that would petrify norms and institutions, yet he would consider as a major threat to the civilization of freedom prophets of emancipation, such as Marx and Freud, who teach that norms and institutions are the primary vehicles of oppression. Being a member of the Great Society, he no longer cherishes any allegiance to premodern communities, which he regards as the relics of the tribal instincts; but at the same time he relies on mores, social conventions, and inherited practices—tacit norms that are largely the cultural legacy of the premodern tradition, untouched by the constructivist spirit of modern rationalism.

Viewed from this perspective the proceduralist-traditionalist dichotomy presents itself not as an inconsistency —"irremediable" and "palpable," as Kley calls it (11-12)—but rather as an attempt to close within one social order and one anthropological vision the two elements without which, Hayek believed, liberal society could not exist. This anthropology may not be inconsistent, but one may well suspect it of cultural anachronism. Just as one might no longer share Hayek's vision of the clear boundaries and identifiable nature of the civilization of freedom, one might also doubt whether the liberal-conservative human beings who supposedly created it still exist in modern society. The concept of man that goes back to the venerable tradition of British moderate conservatism does not ac-

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cord easily with today's cultural idiom, which concentrates more on "marginality" (Gray 1993, 263) and "modularity" (Gellner 1994, 97–102); and any theory that is implicitly built on such a man is bound to look anachronistic. At the same time one must be aware of the limited nature of this complaint: we cannot know for certain if what looks anachronistic today may not look appealingly modern after some unpredictable tide of future history.

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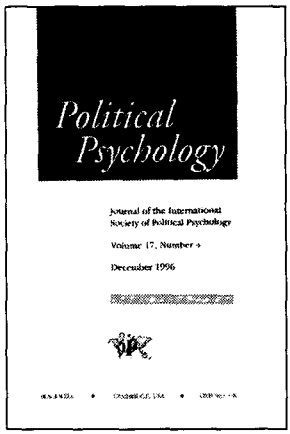

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